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IN THE

Supreme Court of the United States

MONUMENTAL LIFE INSURANCE COMPANY
(Successor in interest to COMMONWEALTH LIFE INSURANCE COMPANY),

Petitioner,

v.

DEPARTMENT OF REVENUE, FINANCE AND ADMINISTRATION CABINET, COMMONWEALTH OF KENTUCKY (f/k/a Revenue Cabinet); LOUISVILLE/JEFFERSON COUNTY METRO GOVERNMENT (f/k/a Jefferson County, Kentucky and the City of Louisville, Kentucky); and KENTUCKY BOARD OF TAX APPEALS,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE KENTUCKY COURT OF APPEALS

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether Section 514 of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), 29 U.S.C. § 1144, preempts the imposition of an *ad valorem* tax imposed under Ky. Rev. Stat. § 136.320 on retirement/pension plan assets held in Separate Accounts and thus bars Respondents Kentucky Department of Revenue and Louisville/Jefferson County Metro Government from including these retirement/pension plan assets in the Ky. Rev. Stat. § 136.320 tax base and calculation and from assessing tax on assets of this nature which has, for decades, not been subjected to this tax?

2. Whether the Kentucky Court of Appeals' decision that shares of stock must be exempted from, but nonetheless included within, the Kentucky *ad valorem* tax base and computation of Ky. Rev. Stat. § 136.320, rather than excluding such shares of stock from the tax base and computation, is in conflict with *St. Ledger v. Kentucky Revenue Cabinet*, 517 U.S. 1206 (1996) and *Fulton Corp. v. Faulkner*, 516 U.S. 325 (1996), specifically as to the remedy Kentucky selected in response to this Court's order in *St. Ledger*, and is also in conflict with other opinions of this Court, including *American Bank and Trust Co. v. Dallas County*, 463 U.S. 855 (1983)?

PARTIES TO THE PROCEEDING

The Petitioner is Monumental Life Insurance Company (Successor in interest to Commonwealth Life Insurance Company). The Respondents are: Department of Revenue, Finance and Administration Cabinet, Commonwealth of Kentucky (formerly known as Revenue Cabinet); Louisville/Jefferson County Metro Government (formerly known, respectively, as Jefferson County, Kentucky and the City of Louisville, Kentucky);[1] and Kentucky Board of Tax Appeals, named as nominal party pursuant to Ky. Rev. Stat. § 13B.140.

RULE 29.6 CORPORATE DISCLOSURE STATEMENT

Petitioner is an indirect wholly owned subsidiary of AEGON N.V., a publicly held company that is listed on the stock exchanges of Amsterdam, London, New York and Tokyo.

Monumental Life Insurance Company is directly owned by two shareholders, Commonwealth General Corporation (99.72%) and General Development Corporation (0.28%), which are each in turn wholly and directly owned by AEGON U.S. Holding Corporation. AEGON U.S. Holding Corporation is wholly and directly owned by Transamerica Corporation, which is in turn

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[1] On January 6, 2003, subsequent to the initiation of the litigation herein, the predecessor governments to Respondent Louisville/Jefferson County Metro Government - the City of Louisville, Kentucky, and Jefferson County, Kentucky - pursuant to Ky. Rev. Stat. § 67C.111, merged to form the Louisville/Jefferson County Metro Government.

wholly and directly owned by The AEGON Trust. The AEGON Trust is in turn wholly and directly owned by AEGON International B.V., which is in turn wholly owned by publicly traded AEGON N.V.

During the years in issue, 1990 through 1998, the predecessor to Petitioner was known as Commonwealth Life Insurance Company, a Kentucky domestic life insurance corporation. Commonwealth Life Insurance Company was a wholly owned subsidiary of Capital Holding Corporation, a corporation traded on the New York stock exchanges, which changed its name to Providian Corporation in 1994. Pursuant to a statutory merger, effective November 30, 1998, Commonwealth Life Insurance Company merged into Monumental Life Insurance Company, and Monumental survived the merger.

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PETITION FOR A WRIT OF CERTIORARI

Petitioner Monumental Life Insurance Company (Successor in interest to Commonwealth Life Insurance Company) respectfully petitions this Court for a writ of certiorari to review the opinion rendered by the Kentucky Court of Appeals on June 27, 2008.

OPINIONS BELOW

The thirty-five page, split decision opinion of the Kentucky Court of Appeals is officially reported at 294 S.W.3d 10 (Ky. App. 2008) and contains an 11-page dissent written by the member of the panel initially designated as the presiding Judge who would have held for Monumental. Pet. App. 1a-39a. A petition for rehearing was denied in an unreported order. Pet. App. 73a-74a. The order of the Kentucky Supreme Court denying Petitioner's motion for discretionary review of the Court of Appeals' opinion is also unreported and attached; but, notably, one Justice went specifically of record in favor of granting discretionary review after another Justice recused. Pet. App. 75a-76a. The opinion and order of the Franklin Circuit Court is also unreported and is reprinted at Pet. App. 46a-57a. The order of the Kentucky Board of Tax Appeals is likewise unreported and is reprinted at Pet. App. 58a-72a.

STATEMENT OF JURISDICTION

The opinion of the Kentucky Court of Appeals was rendered on June 27, 2008. Pet. App. 1a. The Petitioner timely filed a petition for rehearing with the Kentucky Court of Appeals on July 17, 2008, which was denied on

September 8, 2008. Pet. App. 73a. Petitioner timely filed a motion for discretionary review with the Kentucky Supreme Court on October 8, 2008, which was denied by unpublished Order on October 21, 2009. Pet. App. 75a. The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1257(a).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The relevant federal statutory provision is section 514 of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), 29 U.S.C. § 1144. Section 514(a) of ERISA states that:

> Except as provided in subsection (b) of this section, the provisions of this subchapter and subchapter III of this chapter shall supersede any and all State laws insofar as they may now or hereafter relate to any employee benefit plan described in section 1003(a) of this title and not exempt under section 1003(b) of this title. This section shall take effect on January 1, 1975.

The primary Kentucky statutory provision at issue, Ky. Rev. Stat. § 136.320, as in effect during the tax years at issue, 1990 through 1998, imposed an *ad valorem* tax[2] on all the intangible personal property of a domestic

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[2] Because of the nomenclature used in the tax computation and its historical roots, the *ad valorem* tax imposed under Ky. Rev. Stat. § 136.320 is often referred to as the "Capital Stock Tax."

life insurance company. In pertinent part, Ky. Rev. Stat. § 136.320 (1)-(3) states:

> (1) Each life insurance company incorporated under the laws of and doing business in Kentucky shall value as of January 1 and report to the department of revenue by July 15, 1966, and by April 1 each year thereafter, on forms prescribed by the department of revenue, the following:
>
> (a) The fair cash value of the company's intangible personal property, hereinafter referred to as "capital," consisting of all money in hand, shares of stock, notes, bonds, accounts and other credits, exclusive of due and deferred premiums, whether secured by mortgage, pledge or otherwise, or unsecured.
>
> (b) The fair cash value of the company's intangible personal property exempt from taxation by law.
>
> (c) The aggregate amount of company's reserves, reduced by the amount of due and deferred premiums, maintained in accordance with the applicable provisions of KRS 304.6-040 and

304.6-130 to 304.6-180, on all outstanding policies and contracts supplementary thereto.

* * *

(2) Based on information supplied by each company and such other information as may be available, the department of revenue shall value each company's "taxable capital" and "taxable reserves" as follows:

(a) "Taxable capital" shall be determined by deducting "taxable reserves" from "capital," less exempt intangible personal property.

(b) "Taxable reserves" shall be determined by multiplying the aggregate amount of reserves as computed in subsection (1) (c) of this section by the percentage determined by dividing "capital," less exempt intangible personal property, by "capital," including exempt intangible personal property.

(3) An annual tax of seventy cents (70¢) on each one hundred dollars ($100) of the fair cash value of "taxable capital" and one-

> tenth of one cent ($.001) on each one hundred dollars ($100) of the fair cash value of "taxable reserves" shall be imposed for state purposes. The tax shall be in lieu of all excise, license, occupational, or other taxes imposed by the state, county, city, or other taxing district, except as provided in subsections (4), (5), and (6) of this section.
>
> * * * *

Ky. Rev. Stat. § 136.320 (1)-(3).

The above-referenced ERISA and tax statutes are reproduced in their entirety at Pet. App. 77a-84a.

STATEMENT OF THE CASE

This case emanates from several assessments of Kentucky *ad valorem* tax imposed under Ky. Rev. Stat. § 136.320 and issued to Petitioner Monumental Life Insurance Company by Respondent Kentucky Department of Revenue for tax years 1995 through 1998, and from Monumental's refund claims for tax years 1990 through 1996, each concerning intangible property as computed and measured on January 1st of each year.

Additional tax results in part from Kentucky's assessment of *ad valorem* tax on retirement/pension plan assets held in Separate Accounts created under Ky. Rev. Stat. § 304.15-390 which had, for decades, not been subjected to this tax. Monumental asserts that Section 514 of the Employee Retirement Income

Security Act of 1974, as amended ("ERISA"), 29 U.S.C. § 1144, preempts the imposition of this tax on retirement/pension plan assets held in Separate Accounts and thus bars the Respondents from assessing this *ad valorem* tax thereon.

Additional tax also results from Kentucky computing Monumental's tax by exempting shares of stock which results in including them in the Ky. Rev. Stat. § 136.320 tax base and computation, rather than excluding shares of stock entirely therefrom. Monumental asserts that Kentucky's methodology is in conflict with this Court's precedent, including *St. Ledger*,[3] and *American Bank* and its historical progeny which stand for the generations old proposition that a state cannot tax indirectly what it cannot tax directly.[4] Thus, this case also concerns Kentucky's denial

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[3] The following constitutes the full citation of judicial disposition of the case: *St. Ledger v. Revenue Cabinet*, No. 90-CI-06075 (Jefferson Cir. Ct. 1992) (RIA); *St. Ledger v. Revenue Cabinet*, Nos. 92-CA-2688-MR & 92-CA-2689-MR, 1994 WL 193908 (Ky. App. 1994), *St. Ledger v. Revenue Cabinet*, 912 S.W.2d 34 (Ky. 1995), *vacated by remand, St. Ledger v. Revenue Cabinet*, 517 U.S. 1206 (1996), *on remand, St. Ledger v. Revenue Cabinet*, 942 S.W.2d 893 (Ky. 1997), *interlocutory relief denied, Revenue Cabinet v. St. Ledger*, 955 S.W.2d 539 (Ky. App. 1997), *writ of certiorari dismissed, St. Ledger v. Kentucky Revenue Cabinet*, 521 U.S. 1146 (1997); *agreed judgment of satisfaction and resolution, St. Ledger v. Revenue Cabinet*, No. 90-CI-06075 (Jefferson Cir. Ct. 1997) (RIA) (concluding this litigation and ordering the issuance of what was ultimately 114,000 refund checks totaling $170 million).

[4] *American Bank & Trust v. Dallas County*, 463 U.S. 855 (1983); *see also, National Life Insurance Co. v. United States*, 227 U.S. 508 (1928).

of Monumental's refund claims for tax years 1990 through 1996 which pertain to the *St. Ledger* litigation.

A. Retirement/Pension Plan Assets Held in Separate Accounts by Monumental as a Fiduciary for Retirees

During the years at issue and for at least the twenty years prior, Commonwealth Life Insurance Company, now Monumental (pursuant to a statutory merger effective November 30, 1998, hereinafter "Monumental") was "a domestic life insurance company which conducts business within the Commonwealth of Kentucky. . . ." *Monumental Life Ins. Co. v. Dep't of Revenue*, 294 S.W.3d 10, 21 (Ky. App. 2008). At that time, and for most years prior, Monumental was Kentucky's largest domestic life insurance company and the largest payor of Ky. Rev. Stat. § 136.320 tax.

Monumental filed an Annual Statement with Kentucky's Insurance Department via the National Association of Insurance Commissioners' ("NAIC") standard "Blue Book," as it likewise did with all other Insurance Commissioners in states where it did business. In each Blue Book, Monumental listed *all* of its assets, liabilities and accounts. Each tax year, Monumental also submitted a copy of the Blue Book to Kentucky.

Monumental also annually filed a NAIC "Green Book" with the Kentucky Insurance Department that detailed its "Separate Accounts" [*see* Ky. Rev. Stat.

§ 304.15-390].[5] A "Separate Account" is not only an account governed by state law, but a term of art specifically governed by and defined for ERISA purposes, as, "an account established or maintained by an insurance company under which income, gains and losses, whether or not realized, from assets allocated to such account, are, in accordance with the applicable contract, credited to or charged against such account without regard to other income, gains, or losses of the insurance company." 29 U.S.C. § 1002(17). Kentucky statutory law authorizes an insurance company to establish Separate Accounts for a retirement or pension plan. *See* Ky. Rev. Stat. § 304.15-390.

The involved Separate Account holdings were comprised of intangible property. *Monumental Life*, 294 S.W.3d at 21. Separate Accounts were detailed in Monumental's Green Book and were summarized in Monumental's Blue Book – listing approximately $6.0 billion dollars of Separate Account assets for the combined years 1995 through 1998 alone.

"The separate account assets consist principally of retirement fund amounts held for distribution to retirees in the future." *Monumental Life*, 294 S.W.3d at 21. Uncontroverted evidence showed that the Separate Account assets were retirement and pension plan assets which were "firewalled," *i.e.*, they could not be used to satisfy Monumental's general liabilities and were not subject to claims of creditors in the event of an

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[5] *See* Pet. App. 85a.

insolvency.[6] While Monumental held legal title to the Separate Account assets under Ky. Rev. Stat. § 304.15-390(6), the record is clear in that the retirees, plan participants, etc. . . . were the beneficial and equitable owners of the corpus and assets.[7]

B. Kentucky's Scheme of Imposing *Ad Valorem* Tax on the Stock of Corporations, Exempting Only the Stock of Kentucky Corporations, and the *St. Ledger* Litigation Finding a Commerce Clause Violation

The *St. Ledger* litigation began in 1990 through a declaratory judgment class action complaint filed in Jefferson County (Louisville), Kentucky Circuit Court that challenged the constitutionality of then Ky. Rev. Stat. § 136.030(1) (the "Exemption Statute") as being violative of the Commerce Clause of the United States Constitution; nearly 8 years later, the result was the issuance of approximately 114,000 refund checks totaling approximately $170 million. This Court is familiar with

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[6] *Id.* at 28 (J. Thompson, dissenting)

> "[A] separate account is a segregated account, distinct from the company's liabilities and assets. The records of the account are kept in a "green book" and all gains and losses are allocated solely to that account."

([ ] added).

[7] *Id.* ("[T]he legal owner of the assets is the insurance company, which has the ability to execute investment decisions but the equitable owner is the contract holder; the third party participant in the pension plan or the annuity.").

St. Ledger. *See St. Ledger v. Kentucky Revenue Cabinet*, 517 U.S. 1206 (1996) (granting certiorari and remanding for further consideration in light of *Fulton Corp. v. Faulkner*, 516 U.S. 325 (1996)); *see also St. Ledger v. Kentucky Revenue Cabinet*, 942 S.W.2d 893 (Ky. 1997), *petition for cert. filed*, No. 97-127 (U.S. Jul. 21, 1997).

The Exemption Statute exempted holdings of stock of corporations which paid *ad valorem* taxes to Kentucky on at least 75% of their property.[8] Under the corporate shares *ad valorem* tax scheme, a Kentucky corporation paid *ad valorem* tax on its property and its Kentucky shareholders paid *ad valorem* tax again on their holdings of corporate shares. This Exemption Statute thus functioned "to avoid double taxation of both a corporation and its shareholders," [*St. Ledger*, 942 S.W.2d at 897], both for Kentucky's shareholders taxed pursuant to Ky. Rev. Stat. § 132.020, which formed the *St. Ledger* class, and those domestic life insurance companies, such as Monumental, taxed pursuant to Ky. Rev. Stat. § 136.320.

On remand from this Court for further consideration in light of *Fulton Corp. v. Faulkner*, 516 U.S. 325 (1996), the Kentucky Supreme Court held that, "*Fulton Corp.*, *supra*, is controlling in this case and, consequently, the Exemption Statute created by KRS 136.030(1) cannot now pass Commerce Clause muster. . . ." *St. Ledger*, 942

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[8] "The individual stockholders of a corporation shall not be required to list their shares for ad valorem taxation so long as the corporation pays taxes to the state of Kentucky on at least seventy-five percent (75%) of its total property, wherever located. . . ." Ky. Rev. Stat. § 136.030(1).

S.W.2d at 896. There, Kentucky's Supreme Court recognized the double tax effect of taxing corporate stock, and acknowledged that such "double taxation is against public policy." *St. Ledger*, 942 S.W.2d at 897. Striking down only the Ky. Rev. Stat. § 136.030(1) exemption (which impacted both Ky. Rev. Stat. §§ 132.020 and 136.320) would have resulted in double taxation of Kentucky corporate shareholders. Accordingly, the Kentucky Supreme Court struck down the statute imposing tax on shares of stock (Ky. Rev. Stat. § 132.020, which was before the Court) *and* the Exemption Statute, as the tax on corporate shares and the Exemption Statute "fit together as hand and glove." *Id.*

> The Exemption Statute [Ky. Rev. Stat. § 136.030(1)], Ky. Rev. Stat. § 132.020, and the Capital Stock Tax [Ky. Rev. Stat. § 136.320] were all entwined; this was judicially acknowledged and resolved several years after the initiation of this litigation when Kentucky's courts ruled in *American Life & Accident Insurance Company of Kentucky, Inc.*, 173 S.W.3d 910 (Ky. App. 2004), *disc. rev. denied*, (Ky. Oct. 12, 2005). Consistent with the evidence of record herein, in *American Life* the Kentucky Court of Appeals observed that, "The [Kentucky] Revenue Cabinet has traditionally interpreted property to be included in the calculation of intangible personal property [under Ky. Rev. Stat. § 136.320] the same as it did under KRS 132.020 [at issue in *St. Ledger*]." *Id.* at 912 ([ ] added). The Court of Appeals concluded that "the tax imposed by KRS 136.320 in its operation, effect, and incidents is an ad valorem property tax." *Id.* at 914.

Notably, the taxpayer in *American Life* sought refunds for several tax years "based on the outcome of *St. Ledger*," and Kentucky issued refunds for those refund claims. *Id.* at 913. Kentucky also issued *St. Ledger* refunds to Monumental, but in calculating them it included all stock investments in the tax base and formulaic tax computation as exempt intangible personal property [Kentucky's position] rather than excluding these stock investments entirely from the tax base and computation [Monumental's position]. *Monumental Life*, 294 S.W.3d at 16-17.

C. Kentucky's "Exemption" Of Stock In Determining the *Ad Valorem* Tax Under Ky. Rev. Stat. § 136.320 Imposes Substantially More Tax than Entirely "Excluding" Stock from the Tax Base and Computation

The *ad valorem* tax computation of Ky. Rev. Stat. § 136.320, has two components: (i) Taxable Capital (taxed at 0.700%) consisting of intangible personal property defined as "all money in hand, ***shares of stock***, notes, bonds, accounts, and other credits . . . ," less Taxable Reserves and exempt intangible personal property; and (ii) Taxable Reserves (taxed at 0.001%) consisting of reserves on all outstanding insurance policies and contracts multiplied by the percentage determined by dividing capital, less "exempt" intangible property, by capital, including exempt intangible property. *See* Ky. Rev. Stat. § 136.320 (emphasis and ( ) added) [Pet. App. 82a-84a].

Although Ky. Rev. Stat. § 136.320 provides a deduction from the tax base for exempt intangible

property, its circular tax computation reduces Taxable Reserves (taxed at 0.001%) and increases Taxable Capital (taxed at 0.700%) when an item is classified as an *exempt* intangible. In contrast, ***no such shift*** occurs when an item is *excluded* because it is not included in any part of the base of capital. Due to the difference in tax rates, Kentucky's act in classifying intangible personal property as "exempt" results in substantially more tax, *i.e.* up to **700 times more,**[9] than the amount resulting from *excluding* such property in capital.

Judge Thompson of the Kentucky Court of Appeals astutely summarized the critical elements and fundamental result of the formulaic tax computation:

> The majority's understanding of this rather complex computation is amiss and is unsupported by evidence in the record. There is an undesirable consequence of including stock in the tax computation: a portion of taxable reserves is shifted to taxable capital when the stock is exempted rather than excluded. Because of the difference in the tax rates under the statute, the exemption method results in a substantially higher tax. Indeed, if there were no difference in the tax consequences if either method were used, there would be no controversy.

Monumental Life, 294 S.W.3d at 26 (J. Thompson, dissenting).

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[9] When the local tax of Louisville/Jefferson County is factored in, this amount climbs to 1,000 times more.

D. The Annual Audits, Monumental's *St. Ledger* Refund Claims, Kentucky's Denials of Same, and the Assessments That Monumental Protested

Each year for decades, Monumental filed its annual tax return with Kentucky (attaching a copy of its Blue Book), Kentucky audited the tax return, and Kentucky issued an audit report. Monumental also annually paid the local option *ad valorem* taxes levied by Respondent Louisville/Jefferson County Metro Government, which were determined solely on the Taxable Capital certified by Kentucky after each annual audit.

Pre-*St. Ledger*, and for all non-Separate Account assets, Kentucky required Monumental to include its investments in shares of stock as Taxable Capital under Ky. Rev. Stat. § 136.320, and Monumental did so. For tax years 1990 through 1996, however, in light of the then pending *St. Ledger* litigation, Monumental also filed annual protective tax refund claims with respect to any potential tax overpayment which may arise therefrom. After the Kentucky Supreme Court issued its 1997 Opinion in *St. Ledger* upon remand from this Court, Kentucky audited Monumental's 1997 tax return and asserted that all stock assets should not be exempted, but rather should be excluded from the Ky. Rev. Stat. § 136.320 tax base and computation. Accordingly, when it filed its 1998 tax return, Monumental *excluded* its stock assets from the tax base and computation. Kentucky subsequently audited Monumental's 1998 return and accepted the *exclusion* of stock assets, which was consistent with Kentucky's advice to all Kentucky taxpayers that they should not list stock or mutual fund assets on their intangible property tax returns post-

St. Ledger. Kentucky also began processing *St. Ledger* refund claims, including Monumental's. *See supra*, note 3.

Then, contrary to both its advice to all taxpayers not to list stock for general *ad valorem* taxation and its *exclusion* of stock from Monumental's 1997 and 1998 tax base and computations, Kentucky reversed course and treated Monumental's stock assets as "exempt" when computing refunds due for 1991 to 1996 – a move which reduced Monumental's *St. Ledger* refund from $8 million plus to less than $1.5 million. Monumental protested Kentucky's change in position.

In response to Monumental's protest and refund claims, Kentucky engaged in an unprecedented *second* audit of Monumental's 1998 return, which resulted in it: (1) recomputing Monumental's 1998 tax by exempting rather than excluding stock; and (2) imposing the tax on Monumental's then $1.9 billion Separate Account retirement assets for **the first time ever**. These actions, which were wholly contrary to Kentucky's decades long approach, increased Monumental's 1998 tax liability from less than $50,000 to more than $3 million. In response to Monumental's protest, Kentucky re-audited other years and issued Notices for years 1995 to 1997, alleging Monumental owed nearly $2.9 million in additional tax (plus interest and penalties) – due to Kentucky's sudden shift[10] to the exemption method and its decision to begin taxing Separate Accounts.

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[10] As Judge Thompson noted in his dissenting opinion, "[T]he actions of the [Kentucky Revenue] Cabinet have a strong implication of retaliation. . . ." *Monumental Life*, 294 S.W.3d at 28 (J. Thompson, dissenting).

Monumental administratively protested, Kentucky issued a final ruling, and Monumental appealed to the Kentucky Board of Tax Appeals.

E. The Issues Raised in this Petition were Properly Preserved For Review

While there is no question that the *St. Ledger* issues were preserved for appeal, the Court of Appeals took the position that the ERISA preemption question was not properly preserved for appeal. Monumental's ERISA preemption argument was undoubtedly preserved, however.

In its Petition of Appeal to the Board, Monumental raised the Separate Accounts issue and, through discovery and at the hearing, introduced evidence supporting its argument that ERISA preempted Kentucky's taxation of Separate Account assets, as it did in its post-hearing briefs filed with the Board. Indeed, the Board acknowledged that Monumental raised what it characterized as the "issue of ERISA" in its brief, though it incorrectly concluded that Monumental did not preserve the "issue" for review:

> The Appellant failed to *raise* the *issue of ERISA* in its Petition of Appeal, or in any other pleading *except its brief*, including the pre-hearing compliance statement and the supplemental pre-hearing compliance statement. Therefore it failed to preserve this issue for review by this Board. The Board will not consider the ERISA issue. *Stoner Creek*

> *Stud v. Revenue Cabinet*, Ky. App., 746 S.W. 2d 73 (1987).

Monumental Life Ins. Co. v. Revenue Cabinet, File No. K00-R-23, Order No. K-19052 (KBTA 2003) (emphasis added) [Pet. App. 64a].[11] The Board then actually ruled on the ERISA preemption question:

> If the issue had been preserved, the Board believes ERISA does not preempt KRS 136.320, because KRS 136.320 has not been shown to have any connection or reference to any benefit plan. KRS 136.320 does not burden any ERISA plan that may exist, does not infiltrate the relationship between employees and their employers or their plan. KRS 136.320 is a neutral tax of general application. *Miller v. PPG Industries, Inc.*, 237 F. Supp 2d 756 (W.D. Ky. 2002).

Monumental Life Ins. Co. v. Revenue Cabinet, File No. K00-R-23, Order No. K-19052 (KBTA 2003) [Pet. App. 70a-71a]. That the Board was sufficiently informed to make conclusions as to the ERISA preemption question and to rule on its merits demonstrates that Monumental timely and properly raised, prosecuted and briefed it.[12] Because

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[11] *See also Monumental Life*, 201 S.W.3d 500 (Ky. App. 2006) (remanding the administrative record to the Board for proper indexing).

[12] The Board's erroneous conclusion that Monumental did not preserve the ERISA "issue," when in fact it did, likely stems from the Board's erroneous characterization of the ERISA question as an "issue" rather than an "argument," – a distinction (Cont'd)

Monumental argued the ERISA preemption question before the Board, submitted evidence on it at the hearing, briefed it to the Board and the Board ruled on it, it is clear that Monumental timely and properly raised the ERISA preemption question.[13]

F. Monumental's Presentation of the ERISA Preemption and *St. Ledger* Questions in the State Court Proceedings Below

In an *original* civil action filed in Franklin Circuit Court, Monumental raised the ERISA and the *St. Ledger* questions in its Petition for Judicial Review/ Statement of Appeal.[14] Monumental also briefed and

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(Cont'd)
of relevance. *Revenue Cabinet v. Babcock & Wilcox Co.*, 203 S.W.3d 149 (Ky. App. 2005), a case issued subsequent to the Board's 2003 Monumental Order and after *Stoner Creek Stud v. Revenue Cabinet*, 746 S.W.2d 73 (Ky. App. 1987) (relied on by the Board in its Order), makes clear both that Monumental preserved the so-called "issue" of whether or not the Separate Accounts should be subject to the Ky. Rev. Stat. § 136.320 tax and that Monumental advanced several "arguments," including that ERISA preempts a tax on Separate Accounts.

[13] "[T]he contentious proceedings before the Board constitutes arbitrary conduct toward Monumental." *Monumental Life*, 294 S.W.3d at 28 (J. Thompson, dissenting). Notably, the Kentucky Court of Appeals separately found that, "the KBTA failed to create and maintain an [orderly and complete] official record. . . ." *Monumental Life*, 201 S.W.3d 500, 502 (Ky. App. 2006). This was, however, subsequently remedied pursuant to the Court of Appeals' published Order.

[14] Ky. Rev. Stat. § 23A.010(4) and Ky. Rev. Stat. § 131.370(1) vest jurisdiction in the circuit courts to review the (Cont'd)

argued these questions to the Franklin Circuit Court. The Franklin Circuit Court upheld the Kentucky Board of Tax Appeals on the *St. Ledger* question and failed to rule on the ERISA preemption question, providing no insight for its silence.

In an appeal of right to the Court of Appeals, Monumental pursued the ERISA preemption and the *St. Ledger* questions in the Prehearing Statement it filed. Monumental also briefed and argued these matters to the Court of Appeals.

While expressly recognizing the retirement/pension plan nature of the Separate Accounts, the dissent would have ruled for Monumental on all issues on independent state law grounds and thus, did not reach the ERISA preemption question. *Monumental Life*, 294 S.W.3d at 26-28. The majority refused to rule on the ERISA preemption question, citing the Kentucky Board of Tax Appeals' determination that Monumental failed to raise the "ERISA issue", stating, "As we have not otherwise been cited to Monumental's proper preservation of the issue, we will likewise not address this argument on the merits." *Id.* at 22. As discussed *supra*, however, Monumental appropriately raised the ERISA preemption question before the Board, and despite its statement that it would not address it, the Board in fact did address the ERISA preemption question on the merits.

(Cont'd)
decisions of administrative boards such as the Board. "Such review shall not constitute an appeal but an original action." KRS 23A.010(4). *See also Dept. of Revenue v. Estate of Hofgesang*, 627 S.W.2d 579, 580 (Ky. 1982).

Moreover, Monumental preserved the ERISA question before the Circuit Court, as discussed *supra*. And, under Ky. R. Civ. P. 76.12(4)(c), "[r]eference to the specific portion of [the] record is not essential where the [issue] was clearly joined at every stage of the proceeding." *Cornette v. Holiday*, 32 S.W.3d 106, 109 (Ky. App. 2000) ([ ] added). As discussed, Monumental timely, appropriately and properly raised, briefed and argued the ERISA question throughout the underlying proceedings; accordingly, the Court of Appeals erred in not addressing the ERISA preemption question on the merits.

As to *St. Ledger*, the majority of the Court of Appeals panel ruled on the *St. Ledger* question, but misconceived not only the issue presented on appeal but more plainly the holding and consequential effect of *St. Ledger*. *See Monumental Life*, 294 S.W.3d at 16-18. In sum the majority held, "We find nothing in the *St. Ledger* opinion which purported to affect KRS 136.320's use of stock in its formulas." *Id.* at 18.[15] The dissent, however,

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[15] Throughout much of its opinion, the majority makes multiple statutory references, ones which are obviously meant to be to KRS 136.320 – the statute which is the core of this appeal – that incorrectly reference "KRS 136.020." *See, e.g., Monumental Life*, 294 S.W.3d at 16, 18-22. And, references obviously meant to be to KRS 132.020 (one of the core statutes addressed in *St. Ledger*) are incorrectly referenced as "KRS 136.020." *See, e.g., Monumental Life*, 294 S.W.3d at 14. In total, there were over 15 flawed references to Kentucky statutes in the Court of Appeals' Opinion. The majority further misstates material facts regarding the origin of the exclusion method and the events surrounding 1997 and 1998 filings and audits.

recognized that *St. Ledger* requires the exclusion of shares of stock from the tax computation of Ky. Rev. Stat. § 136.320. *Id.* at 24-26. As eloquently observed by Judge Thompson in his dissent:

> The majority believes the Supreme Court's opinion [in *St. Ledger*] was limited strictly to KRS 132.020 but I am not persuaded. Our highest Court's intent was to declare all ad valorem taxes on the ownership of corporate shares forbidden unless the legislature clearly states to the contrary. If, as the majority suggests, our judicial opinions are limited to the facts presented without bearing on future cases, our law is destined to stagnation and no longer a moving stream guided in its journey by precedent.

Id. at 25 ([ ] supplied).

Monumental then advanced a Petition for Rehearing, again raising the ERISA question and the *St. Ledger* question. The Court of Appeals denied the petition. Pet. App. 73a-74a. Finally, Monumental sought discretionary review from the Kentucky Supreme Court on these questions. That court denied the motion. Pet. App. 75a-76a.

As highlighted above, although the Kentucky Circuit Court and Court of Appeals have addressed the *St. Ledger* question, the Kentucky courts have sidestepped the ERISA preemption question even though Monumental continually raised, briefed and argued it at every opportunity. Unfortunately, the

Kentucky Supreme Court also sidestepped this important ERISA preemption question, which arises here in the context of taxes, by denying discretionary review, as it did in another case involving the tax consequences deriving from intangible property. *See Davis v. Dep't of Revenue*, 197 S.W.3d 557 (2006), *discretionary review denied*, No. 2006-SC-000105 (Ky. 2006), *rev'd by, Dep't of Revenue v. Davis*, 553 U.S. 328 (2008). This Court granted certiorari in *Davis* and reversed the Kentucky Court of Appeals; it should likewise grant certiorari here.

REASONS FOR GRANTING THE PETITION

I. The Kentucky Forums' Collective Failure to Find that ERISA Preempts an *Ad Valorem* Tax on Retirement/Pension Plan Assets Conflicts with ERISA Jurisprudence of This Court and Other State Courts

The insurance industry uses Separate Accounts as a way of managing ERISA retirement/pension plan assets. Indeed, the vast majority of states have statutes providing for Separate Accounts.[16] Moreover an *ad valorem* property tax is a prevalent type of tax in the United States as demonstrated by the many decisions of this Court concerning *ad valorem* taxes. *See, e.g., Fulton Corp. v. Faulkner*, 516 U.S. 325 (1996); *St. Ledger v. Kentucky Revenue Cabinet*, 517 U.S. 1206

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[16] *See* National Association of Insurance Commissioners, N.A.I.C. Model Laws, Regulations and Guidelines (2009), NAIC 260-5 & NAIC 260-9 (Westlaw).

(1996).[17] ". . . [T]he taxation of Monumental's separate account is repugnant to basic principles of taxation." *Monumental Life*, 294 S.W.3d at 24 (J. Thompson, dissenting). Thus, it is important to determine whether assets held in Separate Accounts are subject to state tax, here *ad valorem* tax, given the magnitude of their use across the country.

A. ERISA Preempts an *Ad Valorem* Tax on Retirement/Pension Plan Assets

In enacting ERISA, "Congress intended . . . to establish pension plan regulation as exclusively a federal concern." *Alessi v. Raybestos-Manhattan, Inc.*, 451 U.S. 504, 523 (1981).

No dispute exists as to what is contained in the Separate Account, "The separate account assets consist principally of retirement fund amounts held for distribution to retirees in the future." *Monumental Life*, 294 S.W.3d at 21; *Id.* at 28 ("[T]he title vested in Monumental is solely for the purpose of managing the investments in the account for the benefit of the equitable title holders, the retirement/pension beneficiaries. . . .") (J. Thompson, dissenting).[18]

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[17] The constitutional validity in application of the *ad valorem* taxes of many states and localities have been the object of this Court's review in cases such as *Polar Tankers, Inc. v. City of Valdez*, 557 U.S. –, 129 S.Ct. 2277 (2009); *R.J. Reynolds Tobacco Co. v. Durham County*, 479 U.S. 130 (1986); *Xerox Corp. v. Harris County*, 459 U.S. 145 (1982); *Japan Line, Ltd. v. Los Angeles County*, 441 U.S. 434 (1979), and countless others.

[18] The Board Record includes the uncontradicted testimony of some of the plan participants that supports the conclusion that the Separate Accounts at issue constitute retirement/pension plans, including a stock thrift plan, annuities, etc. . . .

As ERISA covers "any employee pension benefit plan" [29 U.S.C. § 1081(a); 29 U.S.C. § 1003(a)], the Separate Accounts consist of ERISA-governed retirement/pension plan assets.[19] Monumental asserts that the involved retirement/pension plan Separate Account assets – approximately $6.0 billion total for years 1995 to 1998 – cannot be subject to *ad valorem* tax – here, resulting in millions of dollars of tax - by including these assets in the Ky. Rev. Stat. § 136.320 tax base because ERISA preempts the imposition of *ad valorem* tax on plan assets via state tax law.

Section 514 of ERISA, 29 U.S.C. § 1144(a), preempts "any and all" state laws, including tax laws, that "relate to" employee benefit plans, including retirement/pension plans. *See Shaw v. Delta Air Lines, Inc.*, 463 U.S. 85, 95-100 (1983); *Egelhoff v. Egelhoff ex rel. Breiner*, 532 U.S. 141, 146-50 (2001).[20] Although ERISA

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[19] It is settled law that ERISA governs a Separate Account. This Court has recognized that ERISA's fiduciary obligations apply even in relation to assets held by an insurer in its General Account [Blue Book] under retirement contracts. *See, e.g., John Hancock Mutual Life Ins. Co. v. Harris Trust and Savings Bank*, 510 U.S. 86, 106-10 (1993) (Brief for Respondent) (("Under ERISA all pension plan assets held in separate accounts [Green Book] are 'plan assets' and therefore subject the insurance company to ERISA's fiduciary duty provisions.") (citing 29 U.S.C. § 1101(b)(2)(B)) ([ ] added).

[20] For other ERISA preemption of state tax cases, *see also E-Systems, Inc. v. Pogue et al.*, 929 F.2d 1100 (5th Cir. 1991), *cert. denied*, 502 U.S. 981 (1991); *NGS American, Inc. et al. v. Barnes*, 805 F. Supp. 462 (W.D.Tex. 1992). As discussed *supra*, the magnitude of the tax involved herein is significant: it involves billions of dollars of assets and millions of dollars of tax.

does not preempt "law[s] . . . which regulat[e] insurance" [29 U.S.C. § 1144(a)], that carve out "saves laws that regulate insurance, not insurers," *Kentucky Ass'n of Health Plans, Inc. v. Miller*, 538 U.S. 329, 334 (2003), and is inapplicable here. *See also E-Systems, Inc. v. Pogues et al.*, 929 F.2d 1100, 1003-04 (5th Cir. 1991), *cert. denied*, 502 U.S. 981 (1991) (finding a state administrative services tax was preempted by ERISA, the Court noted, "Although [the savings] clause lifts the effect of the preemption from any state law which regulates 'insurance, banking or securities,' 29 U.S.C. § 1144(b)(2)(A), the deemer clause, 29 U.S.C. § 1144(b)(2)(B), declares that no state law regulating insurance shall deem an ERISA plan to be engaged in the business of insurance.") ([ ] added). Ky. Rev. Stat. § 136.320 in no way regulates insurance; rather, it imposes an *ad valorem* tax on intangible assets. As such, ERISA preempts the application of this statute to the involved pension assets, provided that it "relates to" them, which it does.

Through ERISA's express text, Congress has avowed its intent that ERISA preempt state tax laws that relate to employee benefit plans.[21] *See* 29 U.S.C. § 1144(b)(5)(B)(i). This Court, in *De Buono v. NYSA-ILA Medical and Clinical Services Fund*, 520 U.S. 806, 815 n.11 (1997), did not give proper weight to the clear

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[21] *See* the historical discussion in Kevin Matz, *ERISA's Preemption of State Tax Laws*, 61 Fordham L. Rev. 401, 410 (1992); Yonatan Gelblum, *Hattem v. Schwarzenegger: Terminating Preemption Challenges to States Taxation of ERISA Plans' Unrelated Business Taxable Income*, 60 Tax Law. 215, 226 (2006); *see also Ret. Fund of the Plumbing, etc., et al. v. Franchise Tax Bd., et al.*, 909 F.2d 1266 (9th Cir. 1990).

text of ERISA in determining its preemptive scope and thus, moved away from the clear rule of this Court that if "the statute contains an express pre-emption clause, the task of statutory construction must in the first instance focus on the plain wording of the clause, which necessarily contains the best evidence of Congress' pre-emptive intent." *CSX Transp., Inc. v. Easterwood*, 507 U.S. 658, 664 (1993); *see Shaw*, 463 U.S. at 95-96; *Egelhoff*, 532 U.S. at 151-52 (holding in an ERISA preemption case that "a presumption against pre-emption in areas of traditional state regulation . . . can be overcome where . . . Congress has made clear its desire for pre-emption."); *Sprietsma v. Mercury Marine, a Div. of Brunswick Corp.*, 537 U.S. 51, 62-63 (2002) (quoting *CSX, supra*, with approval). Congress' clear intent for ERISA preemption should apply herein consistent with this Court's jurisprudence as to the importance of textual evidence of congressional intent.

29 U.S.C. § 1144(b)(5)(B)(i) explicitly and plainly expresses Congress' intent to preempt "any State tax law relating to employee benefit plans. . . ."[22] Here, there is no history of Kentucky assessing Ky. Rev. Stat. §136.320 tax on retirement/pension plan Separate Account assets. *Monumental Life*, 294 S.W.3d at 28 (Ky. App. 2008) (J. Thompson, dissenting).

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[22] Legislative history is consistent with the intent that ERISA's preemptive scope encompasses state taxes – of all varieties – that relate to ERISA plans. "Preemption is *continued* with respect to . . . any State tax law *relating to* employee benefit plans." H.R. Conf. Rep. No. 97-984, 97th Cong., 2d Sess., 18, *reprinted in* 1982 U.S. Code Cong. & Admin. News 4598, 4603 (emphasis added).

"A law 'relates to' an employee benefit plan, in the normal sense of the phrase, if it has a [1] connection with or [2] reference to such a plan." *Shaw*, 463 U.S. 85, 96-97 (1983) ([ ] added). S*ee also Egelhoff*, 532 U.S. at 147 (quoting *Shaw, supra*). This case concerns a state tax law that has an "impermissible connection with" an employee benefit plan.[23]

ERISA preempts general laws with an "impermissible connection with" an employee benefit plan. *See Egelhoff*, 532 U.S. at 143, 147-50. It is difficult to conceive a general tax law that is more impermissibly connected with/to an ERISA plan than an *ad valorem* tax imposed directly on ERISA governed plan assets. The impermissible connections here are evident and manifest themselves in multiple ways.

Most obviously, here, Ky. Rev. Stat. § 136.320 imposes a tax directly on the assets of an ERISA plan, such as the involved retirement/pension plan assets in the Separate Accounts. That is just the first direct tie in the Gordian Knot connecting ERISA plan assets and Ky. Rev. Stat. § 136.320, which is further tightened by Kentucky's *ad valorem* tax scheme. Ky. Rev. Stat. § 134.060 makes the "holder[s] of the legal title [Monumental], the holder of the equitable title [the retirees/pentioners], and the claimant or bailee in possession of the property on the assessment date . . . [personally] liable for taxes thereon. . . ." Ky. Rev. Stat.

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[23] Testimony developed herein demonstrates Kentucky's flawed administrative position that ERISA governs the beneficiaries of a plan, and not the plan or corpus.

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§ 134.060 ([ ] & footnote added).[24] The statute then provides that the **equitable owner** [here, the owner of the involved retirement plans, or the beneficiaries thereof, etc.] is liable for the taxes as between themselves – so, even if Monumental can be taxed by Kentucky, the tax is, as a matter of Kentucky law, owed by the ERISA plan beneficiaries who are the equitable owners of the plan assets.[25]

Moreover, Ky. Rev. Stat. § 134.420 imposes a lien presumably on the involved underlying assets, should the taxes due become delinquent.[26] But, failure to pay the tax can cost Monumental its insurance license

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[24] As testified to herein, this tax statute surely encompasses the ERISA plan fiduciary, here, Monumental, the pension plans of the Separate Account and the beneficiaries thereof, and Kentucky has construed it in this manner.

[25] *See, e.g., Monumental Life*, 294 S.W.3d at 26 (J. Thompson, dissenting)

> "A purchaser of an annuity or a contributor to a pension plan has paid taxes or has deferred the payment of taxes on the funds invested in the annuity or pension plan. These funds are placed into the care and custody of Monumental Insurance Company. To again tax these funds as an asset of Monumental Life Insurance Company constitutes double taxation of the participant in the retirement plan or annuity and diminishes the income to that third party by the taxation of the account."

[26] Courts have repeatedly held that lien provisions on plan assets violate and are preempted by ERISA. *See McCoy v. Massachusetts Institute of Technology*, 950 F.2d 13, 18 (1st Cir. 1991) *cert. denied*, 504 U.S. 910 (1992).

[Ky. Rev. Stat. § 304.4-040] – so Kentucky has forced the payment [which then creates liability with the equitable and beneficial owners pursuant to Ky. Rev. Stat. § 134.060]. This impermissibly binds plan administrators to make payments dictated by state law instead of by the ERISA plan documents. As with the state law at issue in *Egelhoff*, failure to preempt a state law of this nature surely has the potential to, "[r]equir[e] ERISA administrators to master the relevant laws of 50 States and . . . would undermine the congressional goal of 'minimiz[ing] the administrative and financial burden[s]' on plan administrators – burdens ultimately borne by the beneficiaries." *Egelhoff*, 532 U.S. at 149-50. *See also*, note 14, *supra*.

Ky. Rev. Stat. § 136.320 likewise binds plan administrators to make payments dictated by state law rather than by the plan documents. *Compare with*, *Egelhoff*, 532 U.S. at 147 ("[T]he [State] statute has an impermissible connection with ERISA plans. . . . The administrators must pay benefits to the beneficiaries chosen by state law, rather than to those identified in the plan documents."). Moreover, it interferes with uniform plan administration because "[u]niformity is impossible . . . if plans are subject to different legal obligations in different States" [*Id.*], and this could certainly occur herein given the breadth of use of Separate Accounts across the country.

Accordingly, ERISA preempts the *ad valorem* tax at issue to the extent that it is imposed on the retirement/pension plan assets held by Monumental in Separate Accounts for the beneficial and equitable owners, participants and retirees.

B. The Opinion of the Kentucky Court of Appeals Is in Conflict with the Opinions of Multiple Circuit Courts of Appeals and State Courts as to ERISA's Preemption of State Tax Laws and Contributes to a Growing Split Across the Nation

The underlying Kentucky Court of Appeal's decision is in conflict with that of other state and federal courts which have recognized that ERISA preempts general state tax laws which have a connection with employee benefit plans. *See, e.g., Morgan Guar. Trust Co. of New York v. Tax Appeals Tribunal of New York State Dep't of Taxation and Fin.*, 599 N.E.2d 656, 660 (N.Y. 1992) (holding ERISA preempted a state tax of general application on a pension plan's gain arising from the sale of real property held by it). Similarly, in *General Motors Corp., et al. v. California State Bd. of Equalization*, 815 F.2d 1305, 1309 (9th Cir. 1987), *cert. denied*, 485 U.S. 941 (1988), the Ninth Circuit Court of Appeals held that, but for application of ERISA's savings clause, a premium tax computed with reference to benefits paid by employee benefit plans would have been preempted.

Here, in declining to find preemption, the Board relied solely on *Miller v. PPG Indus., Inc.*, 237 F. Supp. 2d 756 (W.D. Ky. 2002), which held that ERISA did not preempt an "insurance payments" exception to municipal occupational license tax only because such payments did not have any notable effects on an ERISA plan, *i.e.* addressing the "remote or peripheral" exception to preemption. Unlike the payments at issue in *Miller*, the *ad valorem* tax at issue in this case has much more than a remote or peripheral connection; it is, as discussed *supra*, intimately connected.

Relatively recently though, a split has emerged among the states' interpretation of ERISA's preemptive scope with regard to whether or not general state taxes are preempted based on the "connection with" prong of the ERISA preemption test, analyzed at length by this Court in *Egelhoff, supra*. In *Hattem v. Schwarzenegger*, 449 F.3d 423 (2nd Cir. 2006), the Second Circuit Court of Appeals held that California's tax on unrelated business taxable income was not preempted by ERISA because it had neither a "connection with" nor a "reference to" an employee benefit plan (citing and departing from the analysis used in *N.Y. State Conference of Blue Cross & Blue Shield Plans v. Travelers Ins. Co.*, 514 U.S. 645, 668 (1995) that "'a state law might produce such acute, albeit indirect, economic effects, by intent or otherwise, as to force an ERISA plan to adopt a certain scheme,' which might result in preemption."). The Second Circuit in *Hattem* gave undue deference to the state's taxing power in excess of that contemplated by Congress, giving the involved state tax law more deference than a general state law. This creates yet another conflict in that it improperly equates a state's taxing power with its police power[27] and is in conflict with the clear intent expressed in ERISA's text and legislative history as to preemption of state tax laws.

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[27] The taxing power of a state is distinct from its police power. *Moorman Mfg.Co. v. Bair*, 437 U.S. 267, 287 (1987) (listing separately the states' "power to tax" and their "police power") (internal quotation marks and citations omitted). *See also W. Lynn Creamery v. Healy*, 512 U.S. 186, 193 (1994).

C. Consistent with the Principle that ERISA Preempts *Ad Valorem* Tax on ERISA Plan Assets, Kentucky Did Not Assess This Tax on the Separate Account Assets for At Least Two Decades Before It Arbitrarily Changed Its Position Post-*St. Ledger*

Significantly, for years Kentucky has publicly acknowledged that ERISA preempts ad valorem tax on retirement/pension assets, via another statute in Kentucky's *ad valorem* intangibles taxing structure, Ky. Rev. Stat. § 132.043.[28] The Kentucky Revenue Cabinet specifically acknowledged that, "Section 514 of ERISA preempts or nullifies KRS 132.043 as it was being administered."[29] *See, e.g.*, Kentucky Revenue Cabinet, *Tax Facts*, (1994 ed., Dec. 30. 1994) Pet. App. 87a.

Consistent with this position, Kentucky did not assess tax on the retirement/pension plan Separate Account. Only after 1998, after Monumental's request for millions of dollars in *St. Ledger* refunds, did Kentucky first impose the tax on Monumental's Separate Accounts in direct contradiction to its publicly stated position that retirement plan assets were not subject to *ad valorem* taxation because of ERISA preemption. Kentucky refused to recognize ERISA's preemptive effect with respect to

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[28] This Kentucky announcement on ERISA preemption is similar to other administrative announcements. *See, e.g.*, Op. Att'y Gen. 78-13 (Idaho Mar. 10, 1978); Dep't of Revenue Notice 92-3 (Minnesota Feb. 3, 1992). The Record herein disclosed a long running dispute between the Revenue Cabinet and the Department of Labor as to the taxability of retirement plans pursuant to Ky. Rev. Stat. § 132.043; Kentucky ultimately ceased taxing retirement plans thereunder.

[29] *See* Pet. App. 86a for the text thereof.

retirement/pension plan assets held in Separate Accounts while continuing to recognize its effect as applied to other retirement plan assets and stock not held in Separate Accounts. This demonstrates the clearly impermissible connection of the tax to ERISA-governed retirement plans assets. As such, the tax is clearly preempted by ERISA.

D. The Need for Clarity as to ERISA's Preemptive Scope Regarding State Tax Laws Necessitates Review by this Court

Determining ERISA's preemptive scope on state taxes in general, and value based taxes such as a state *ad valorem* tax directly on plan assets in particular, is vital to all retirement/pension plans, the fiduciaries thereof, and the current or future retirees that participate in those plans. Clarity is critical in this area of law – especially as to state tax law that is impermissibly "connected with" ERISA plans and Kentucky's history of attempting to tax pension plan assets.[30] It is an issue on which this Court should consider and rule.[31]

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[30] *See Monumental Life*, 294 S.W.3d at 27 (J. Thompson, dissenting) (giving an example of the problem herein, "If an individual desires to establish a pension plan and places his pension plan into the trust of his stockbroker or his bank and designates that shares of stock be purchased by his pension plan for his retirement, those shares will not be taxed. However, if that same person were to invest his pension plan with Monumental who utilizes their expertise to invest shares of stock on his behalf for his retirement, then his shares will be taxed.").

[31] "The law of ERISA preemption has been called a '"morass"' and a black hole which swallows up garden variety claims. . . ." *Shofer v. Stuart Hack Company, et al.*, 595 A.2d 1078, 1082 (Md. App. 1991), *cert. denied*, 502 U.S. 1096 (1992) (citations and quotations omitted).

II. Kentucky Courts Have Neglected To Follow and Properly Apply This Court's Precedent In *St. Ledger* and *Fulton*

A. A Conflict Exists Between the Court of Appeals' Holding in this Case and the Holdings in *St. Ledger*, Which Involved the Exact Same Constitutionally Infirm Statute, and *Fulton*

The Kentucky Court of Appeals' application of *St. Ledger* in *Monumental Life*, the subject of this Petition for a Writ of Certiorari, is in direct conflict with this Court's holding in *St. Ledger* and in *Fulton Corp. v. Faulkner*, 516 U.S. 325 (1996), regarding the remedy for the constitutional infirmity concerning the Exemption Statute.

In *St. Ledger*, the Kentucky Supreme Court acknowledged that striking down only the Exemption Statute (which applied to both Ky. Rev. Stat. §§ 132.020 and 136.320) would have resulted in double taxation of Kentucky corporate shareholders. "[D]ouble taxation is against public policy," [*St. Ledger*, 942 S.W.2d at 897], a point well stated by the Kentucky Supreme Court and likewise adopted by this Court long ago. "[D]ouble taxation is a constitutionally disfavored state of affairs. . . ." *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159, 193 (1983).

Given the clear policy against double taxation, the Kentucky Supreme Court struck down both the tax on shares of stock (Ky. Rev. Stat. § 132.020, which was then before the Court) and the Exemption Statute, since the

tax on corporate shares and the Exemption Statute "fit together as hand and glove." *Id.* The effect of this holding was to sever the Exemption Statute [Ky. Rev. Stat. § 136.030(1)] in its entirety and, significantly, to *sever* "shares of stock" from Ky. Rev. Stat. § 132.020. This was the chosen remedy for the constitutionally infirm discriminatory situation found by this Court. *See St. Ledger v. Kentucky Revenue Cabinet*, 517 U.S. 1206 (1996) (granting certiorari and remanding for further consideration in light of *Fulton Corp. v. Faulkner*, 516 U.S. 325 (1996)); *Fulton Corp. v. Faulkner*, 516 U.S. 325 (1996).

In *Fulton*, this Court directed two basic approaches to remedy a discriminatory tax scheme – retroactively impose equal burdens of tax *or* refund the additional taxes imposed on the victims:

> North Carolina's intangibles tax facially discriminates against interstate commerce, it fails justification as a valid compensatory tax, and, accordingly, it cannot stand. At the same time, of course, it is true that "a State found to have imposed an impermissibly discriminatory tax retains flexibility in responding to this determination." *McKesson Corp. v. Division of Alcoholic Beverages and Tobacco, Fla. Dept. of Business Regulation*, 496 U.S. 18, 39-40, 110 S.Ct. 2238, 2252, 110 L.Ed.2d 17 (1990). In *McKesson*, for example, we said that a State might refund the additional taxes imposed upon the victims of its discrimination or, to the extent consistent with other constitutional provisions (notably

> due process), retroactively impose equal burdens on the tax's former beneficiaries.

Fulton, 516 U.S. at 346-347. The critical point is that, under *Fulton* and the case law and authorities relied on therein, all victims of the discriminatory circumstance must receive the same treatment.

In *St. Ledger*, Kentucky chose to refund the additional *ad valorem* taxes imposed on the victims' shares of stock. The Court of Appeals' decision herein is completely contrary to the decision by the Kentucky Supreme Court in *St. Ledger* which was based on this Court's directives in *St. Ledger* and *Fulton*.

Had Monumental been a *St. Ledger* class plaintiff, surely "shares of stock" would have been struck from Ky. Rev. Stat. § 136.320 as it was from Ky. Rev. Stat. § 132.020 to avoid double taxation. But here, the Court of Appeals read *St. Ledger* to exempt rather than exclude stock, approving a method which fails to fully refund all of the tax imposed on Monumental's shares of stock by the constitutionally infirm intangibles scheme.

The lower court's refusal to afford Monumental the relief required by this Court's opinions in *St. Ledger* and *Fulton* is erroneous and should be corrected by this Court.

B. The Court of Appeals' Decision that Shares of Stock May Be Included In and Then Exempted From the Kentucky *Ad Valorem* Tax Base and Computation, Rather than Completely Excluded from the Tax Base and Computation, Conflicts with this Court's Opinions

The tax which results from exempting stock is substantially more than that which results from excluding it from the tax base and computation of Ky. Rev. Stat. § 136.320. This occurs because even if "shares of stock" are treated as exempt, they are still included and considered in the tax base and computation; they are not so considered, however, when they are excluded from the tax base and computation altogether – as would have occurred if "shares of stock" had been severed from Ky. Rev. Stat. § 136.320 in light of *St. Ledger. Monumental Life*, 294 S.W.3d at 26 (J. Thompson, dissenting), *American Bank & Trust Co. v. Dallas County*, 463 U.S. 855 (1983), and other holdings of this Court, *Hunt-Wesson v. California*, 528 U.S. 458 (2000), *Trinova Corp. v. Michigan*, 498 U.S. 358 (1991), and *National Life Insurance Co. v. United States*, 227 U.S. 508 (1928), best illustrate this concept.

In *American Bank, supra*, this Court considered the application of a statutory exemption for federal obligations in the context of a property tax Texas imposed on bank shares when Texas taxing authorities, in determining the value of bank shares subject to tax, considered the value of federal obligations held by the subject banks. *American Bank*, 463 U.S. at 859-60. This Court held that "the tax [on federal obligations] is

barred regardless of its form if federal obligations must be considered, either directly or indirectly, in computing the tax." *Id.* at 862. Since federal obligations were considered in computing the tax, the tax failed to truly exempt federal obligations from tax and was therefore invalid. *Id.* at 862-65.

Similarly, the integrated Ky. Rev. Stat. § 136.320 computation – particularly the percentage reduction of Taxable Reserves (taxed at 0.001%) computed with reference to exempt intangible personal property [Ky. Rev. Stat. § 136.320(2)(b)], which in turn increases Taxable Capital [Ky. Rev. Stat. § 136.320(2)(a) (taxed at 0.700%)] by the amount of the reduction in Taxable Reserves – "considers" (what should be) exempt intangible personal property. Although this statute provides a deduction for exempt intangible personal property, Kentucky's interpretation improperly considers such exempt property in its computation. *See also Monumental Life*, 294 S.W.3d at 26 (J. Thompson, dissenting) (referring to the testimony of Monumental's expert with approval).

Consideration of exempt property in the tax computation results in a shift of the tax base from Taxable Reserves to Taxable Capital creating additional tax. Thus, it does not truly result in a refund all of the discriminatory tax imposed on Monumental that resulted from the Exemption Statute [Ky. Rev. Stat. § 136.030(1)], which was held to be constitutionally infirm in *St. Ledger* as required by *Fulton*, and the cases cited therein.

The approach adopted and defended by Kentucky and upheld by the Kentucky Courts is thus in conflict with this Court's clear rule against taxing indirectly that which cannot be taxed directly. Ample decisions of this Court evidence this rule. *See, e.g., American Bank, supra*; *Hunt-Wesson v. Franchise Tax Bd. of California*, 528 U.S. 458, 464 (2000) (". . . [A] tax on sleeping measured by the number of pairs of shoes you have in your closet is a tax on shoes . . . [quoting *Trinova Corp. v. Michigan Dep't of Treasury*, 498 U.S. 358, 374 (1991)] . . . and for that reason, that which California called a deduction limitation would seem, in fact, to amount to an impermissible tax. . . ." [citing to *National Life Ins. Co. v. United States*, 277 U.S. 508 (1928)]); *National Life*, 277 U.S. at 519 ("One may not be subjected to greater burdens upon his taxable property solely because he owns some that is free . . . to determine what the burden is requires consideration of the mode of assessment, including, of course, deductions from gross values. What remains after subtracting all allowances is the thing really taxed."). Judge Thompson of the Kentucky Court of Appeals recognized this fundamental rule when he stated,

> Although KRS 136.320 does not impose a direct tax on stock, the majority's interpretation permits an indirect tax that is equally offensive. A state cannot tax indirectly that which it cannot tax directly. Thus, I would hold that to avoid double taxation, shares of stock must be excluded rather than exempted, under KRS 136.320.

Monumental Life, 294 S.W.3d at 32 (J. Thompson, dissenting) (citation omitted).

While *American Bank* and *National Life* relate to federal statutes, the principles first set out therein generations ago by this Court are sound and logical, and their application appropriate to this similarly integrated, state tax computation. Thus, the decision below to treat "shares of stock" as exempt property included in the Ky. Rev. Stat. § 136.320 tax base and computation rather than excluding "shares of stock" therefrom in a manner and form consistent with the remedy applied by the Kentucky Supreme Court in *St. Ledger* in light of this Court's decisions in *St. Ledger* and *Fulton* is in conflict with this Court's decisions in, *inter alia*, *American Bank et al.*, and is so flawed as to require this Court to correct it.

CONCLUSION

For the reasons state above, the Petition for a Writ of Certiorari should be granted.

Respectfully submitted,

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APPENDIX

APPENDIX A — OPINION OF THE COMMONWEALTH OF KENTUCKY, COURT OF APPEALS DATED JUNE 27, 2008

COMMONWEALTH OF KENTUCKY
COURT OF APPEALS

NO. 2005-CA-002148-MR

MONUMENTAL LIFE INSURANCE COMPANY, SUCCESSOR IN INTEREST TO COMMONWEALTH LIFE INSURANCE COMPANY,

APPELLANT

v.

THE DEPARTMENT OF REVENUE, FORMERLY KNOWN AS THE REVENUE CABINET, FINANCE AND ADMINISTRATION CABINET, COMMONWEALTH OF KENTUCKY; LOUISVILLE/JEFFERSON COUNTY METRO GOVERNMENT, FORMERLY KNOWN AS CITY OF LOUSVILLE, KENTUCKY AND JEFFERSON COUNTY, KENTUCKY; AND KENTUCKY BOARD OF TAX APPEALS,

APPELLEES

Appendix A

BEFORE: THOMPSON, JUDGE; BUCKINGHAM AND HENRY, SENIOR JUDGES.[1] BUCKINGHAM, SENIOR JUDGE, CONCURS. THOMPSON, JUDGE, DISSENTS AND FILES SEPARATE OPINION.

OPINION
AFFIRMING

HENRY, SENIOR JUDGE: Monumental Life Insurance Company (Monumental) appeals from an opinion and order of the Franklin Circuit Court affirming an order of the Kentucky Board of Tax Appeals (Board) that denied Monumental's tax refund claims for the tax years 1990 through 1996. Monumental also appeals from the Board's denial of its request for relief from additional tax assessments issued by the Revenue Cabinet (Cabinet), the City of Louisville, and Jefferson County for the tax years 1995 through 1998.[2] The primary issues raised are (1) whether the Cabinet erroneously treated the value of investment corporate stock held by Monumental when computing its tax liability pursuant to Kentucky Revised Statutes (KRS) 136.320 for the years 1990 through 1996 (referred to by the parties as the "capital stock tax"), and (2) whether the Cabinet

1. Senior Judges David C. Buckingham and Michael L. Henry sitting as Special Judges by assignment of the Chief Justice pursuant to Section 110(5)(b) of the Kentucky Constitution and KRS 21.580.

2. For convenience, we include appellees the City of Louisville and Jefferson County in our references to the Cabinet. These governmental units support the Cabinet's determinations.

properly subjected assets booked as "separate accounts" to taxation during the years 1995 through 1998.

Monumental is a domestic life insurance company which conducts business within the Commonwealth of Kentucky and is, therefore, subject t KRS 136.320, which requires that it pay a property tax on its "taxable capital" and "taxable reserves."[3] Taxable capital is taxed at a rate of 0.7%, while taxable reserves are taxed at the significantly lower rate of 0.001%. KRS 136.320(3). Taxable capital includes the fair cash value of the company's intangible property, including shares of stock, less taxable reserves and exempt intangible property. KRS 136.320(2)(a). Taxable reserves consists of reserves on all outstanding insurance policies and contracts multiplied ". . . by the percentage determined by dividing capital, less exempt intangible personal property, by capital including exempt intangible personal property." KRS 136.320(2)(b). During the period at issue Monumental also paid local option ad valorem taxes levied by the City of Louisville and Jefferson County that were determined on the basis of its taxable capital as certified by the Cabinet.

In anticipation of the resolution of *St. Ledger v. Revenue Cabinet*, 912 S.W.2d 34, 42 11 Ky. L. Summary 24 (Ky. 1995), *vacated by remand*, St Ledger v. Kentucky Revenue Cabinet, 517 U.S. 1206, 116 S.Ct. 1821, 134

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3. All references to KRS 136.320 are to the statute as it existed prior to 1998, when the tax was changed to include a premium tax.

L.Ed.2d 927 (1996), *on remand*, St. Ledger v. Revenue Cabinet, 942 S.W.2d 893, 44 2 Ky. L. Summary 18 (Ky. 1997), *cert. dismissed*, St. Ledger v. Kentucky Revenue Cabinet, 521 U.S. 1146, 118 S.Ct. 27, 138 L.Ed.2d 1057 (1997), Monumental began filing annual protective refund claims with the Cabinet, the City of Louisville and Jefferson County. *St. Ledger*[4] dealt with the constitutionality of KRS 136.020 (which, among other things, imposed a corporate ad valorem tax on various property, including stock) and KRS 136.030(1) (which exempted from ad valorem taxes the stock held by individual shareholders of corporations which paid Kentucky taxes on at least 75% of its total property).[5] As further discussed below, the *St. Ledger* decision expressly held KRS 136.020 and KRS 136.030(1) to be unconstitutional.

Following the finality of *St. Ledger*, Monumental adopted the position that all stock assets should be excluded from the ad valorem tax calculations imposed under KRS 136.320. It accordingly filed its 1997 and 1998 tax returns reflecting this position. The Cabinet initially accepted the Monumental method, though the Cabinet states that this was a result of auditor error.

Following the Kentucky Supreme Court's decision in *St. Ledger*, the Cabinet began processing the many

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4. Unless the context indicates otherwise, references to *St. Ledger* refer to the 1997 Kentucky Supreme Court decision in the cause.

5. This statute is sometimes referred to in the record as the "exemption statute."

refund claims owed taxpayers as a result of the decision, including Monumental's protective refund claims filed between 1991 and 1996. In calculating the tax due, rather than excluding stock altogether pursuant to Monumental's proposed method, the Cabinet treated Monumental's stock assets as exempt intangible personal property in the KRS 136.320 calculations resulting in a total refund due of $1,470,357.49. Monumental protested the Cabinet's refund amount on the basis that *St. Ledger* required that stock holdings be altogether excluded from the formula. Using this method, Monumental calculated a total refund due of $8,107,668.00 plus additional interest.

During the protest process, the Cabinet again audited Monumental's 1998 return. As a result of the audit the Cabinet determined that Monumental had failed to include in its ad valorem report holdings booked to an account titled "separate accounts," which consists primarily of pension and retirement assets held in Monumental's name for future payout to retirees. The Cabinet thereafter recomputed Monumental's 1998 tax liability to include these assets, with the result that Monumental's liability increased from $48,672 to $3,061,280. The Cabinet also recomputed Monumental's tax liability for the years 1995 through 1998 to take into account separate account assets, and assessed an additional $ 2,895,878.42 for those years.[6]

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6. These assets had similarly not been taxed in years prior to 1995; however, pursuant to the applicable statute of limitations, 1995 was as far back as the Cabinet could go.

Appendix A

The matter was brought before the Board which, after an evidentiary hearing, upheld the Cabinet's ruling. The Franklin Circuit Court affirmed the Board's ruling. This appeal followed.

STANDARD OF REVIEW

KRS 131.370 sets out the appeals procedure from an order of the Board, and provides that such appeals are to be "in accordance with KRS Chapter 13B." According to KRS 13B.150(2), we may not substitute our judgment for that of the agency as to the weight of the evidence on questions of fact. KRS 13B.150(2) further provides that we may reverse the KBTA's final order, in whole or in part, only if we find that the order is:

> (a) In violation of constitutional or statutory provisions;
>
> (b) In excess of the statutory authority of the agency;
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> (c) Without support of [**7] substantial evidence on the whole record;
>
> (d) Arbitrary, capricious, or characterized by abuse of discretion;
>
> (e) Based on an ex parte communication which substantially prejudiced the rights of any party and likely affected the outcome of the hearing;

(f) Prejudiced by a failure of the person conducting a proceeding to be disqualified pursuant to KRS 13B.040(2); or

(g) Deficient as otherwise provided by law.

Consistent with the general standard applicable to appeals from administrative agencies, courts are limited to reviewing findings of fact based on the substantial evidence rule. Where the administrative agency's findings of fact are supported by substantial evidence, those findings are binding on the reviewing court; this is true even though there may be conflicting evidence in the record. *Urella v. Kentucky Bd. of Medical Licensure*, 939 S.W.2d 869, 44 3 Ky. L. Summary 23 (Ky. 1997); *H & S Hardware v. Cecil and Kentucky Unemployment Insurance Commission*, 655 S.W.2d 38, 40 (Ky.App. 1983). Substantial evidence is evidence taken by itself or as a whole that "has sufficient probative value to induce conviction in the minds of reasonable men." *Commonwealth of Kentucky, Cabinet for Human Resources v. Bridewell*, 62 S.W.3d 370, 373 (Ky. 2001). Issues of law, however, as always, are reviewed de novo. *Gosney v. Glenn*, 163 S.W.3d 894, 898 (Ky.App. 2005); *Reis v. Campbell County Bd. of Educ.*, 938 S.W.2d 880, 43 13 Ky. L. Summary 16 (Ky. 1996) (Legal errors of administrative body may always be corrected by reviewing court).

Appendix A

ST. LEDGER'S EFFECT UPON TAXABILITY OF STOCK

Monumental alleges that as a result of the Kentucky Supreme Court's decision in *St. Ledger*, its stock holdings are not subject to ad valorem taxes, and must be excluded from any part of the tax computation under KRS 136.320. Monumental asserts that *St. Ledger* did not merely alter how the capital stock tax was to be calculated, but instead mandated that all stock be excluded from the tax calculation. Under its interpretation, the Kentucky Supreme Court's opinion was sufficiently broad so as to sever from KRS 136.320 as unconstitutional the statute's reference in Section (1)(a) to "shares of stock." Thus, Monumental contends that all stock must be excluded from the calculations under KRS 136.320. Under Monumental's calculation, stock is factored completely out of the tax calculation (this method is referred to in the record as the "exclusion method"), whereas the Cabinet uses stock holdings in its calculations to first include stock in the calculation of capital under Section (1)(a), and then to deduct the value of the stock as "exempt intangible personal property" in the calculations in Sections (2)(a) and (2)(b) (this method is referred to in the record as the "exemption method"). Pursuant to the resulting mathematics, the exclusion method results in a lower tax liability than the exemption method.

Because this argument involves the interpretation of *St. Ledger* and KRS 136.020 — issues of law — our standard of review is de novo. *Gosney v. Glenn*, *supra*.

Appendix A

The issues in *St. Ledger* concerned the corporate shares tax contained in KRS 132.020(1), which imposed an ad valorem tax on stock shares, and the exemption statute contained in KRS 136.030(1).[7] KRS 132.020(1) levied an ad valorem tax of twenty-five cents upon each one hundred dollars of value of, among other things, shares of stock. Pursuant to the exemption statute, KRS 136.030(1), individual shareholders were "not required to list their shares for ad valorem taxation so long as the corporation pays taxes to the state of Kentucky on at least 75% of its total property." Based on the United States Supreme Court decision in *Fulton Corp. v. Faulkner*, 516 U.S. 325, 116 S.Ct. 848, 133 L.Ed.2d 796 (1996), the *St. Ledger* Court first held that the exemption statute violated the Commerce Clause as discriminatory against out-of-state corporations, and, was, therefore, unconstitutional. United States Constitution, Art. 1 § 8, c. 3.

Having held the exemption statute, KRS 136.030(1), unconstitutional, the Court then considered whether the corporate shares ad valorem tax under KRS 132.020(1) could remain in effect. Relying on the expressed policy of the Commonwealth that double taxation is prohibited, it concluded that shares of stock could not be taxed pursuant to KRS 132.020(1), and likewise struck it as unconstitutional in recognition that the legislature had

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7. Also addressed in *St. Ledger* was the constitutionality of KRS 132.030, the bank deposits tax, which treated taxation of in-state and out-of state bank deposits differently. The Court's ruling in that regard is not relevant to our present discussion.

originally enacted the exemption statute, KRS 136.030(1), to avoid double taxation of Kentucky's corporate shareholders. Since striking only the exemption statute and leaving KRS 132.020(1) intact "would result in the taxation of not only corporations but also their shareholders," KRS 132.020 was likewise declared invalid insofar as it taxed shares of stock. The decision in *St. Ledger* explained the Court's reasoning as follows:

> [T]his Court has ruled that double taxation is against public policy and will be permitted only when the Legislature has clearly declared a contrary policy. *Kentucky Power Co. v. Revenue Cabinet*, Ky., 705 S.W.2d 904 (1985). As we determined in *George v. Scent*, Ky., 346 S.W.2d 784 (1961), statutes are to be construed in a manner which avoids double taxation in any form, even if the double taxation is the result of imposition of a tax by another governmental authority. Thus, by enacting the Exemption Statute, the Legislature clearly indicated that the double taxation of Kentucky's corporate shareholders should be avoided. Accordingly, we must consider the Corporate Shares Tax and the Exemption Statute inseparable, because the striking of the Exemption Statute would result in the taxation of not only corporations, but also their shareholders, a result in direct contravention of the expressed intent of the General Assembly.

Id. at 897.

In summary, *St. Ledger* struck down KRS 136.030(1) as unconstitutional pursuant to the federal commerce clause, and KRS 132.020 to avoid double taxation. Despite this relatively straight-forward holding, in support of its argument Monumental claims that *St. Ledger* held "that stock assets could not be subject to valuation-based ad valorem taxation." However, not only does *St. Ledger* make no such statement, but the Court in that decision declined to disturb any of its previous holdings specifically approving the ad valorem taxation of corporate shares. Moreover, KRS 136.320 is not mentioned at all in the *St. Ledger* opinion.

With the foregoing said, we believe the argument in this case is not about whether or not stock holdings are to be taxed in Kentucky as a result of *St. Ledger*. We believe that under the Cabinet's method they are not.[8] However, Monumental appears to believe that *St. Ledger* changed the character of shares of corporate stock into something akin to radioactive material for

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8. We note that following the *St. Ledger* decision the General Assembly repealed KRS 136.030 and removed the reference to stock from KRS 132.020. Monumental's refund claims apply to times when the prior versions of those statutes were still in effect. Even though KRS 136.320 has neither been repealed nor amended to delete its reference to shares of stock as a component of "capital," after *St. Ledger* the Cabinet exempted their value from the tax imposed by that statute. However, we believe that *St. Ledger* did not specifically require such an exemption. While a number of possible reasons for this concession by the Cabinet come to mind (*see, e.g., St. Ledger* at 903, Graves, J., dissenting in part) no specific reason has been offered by the Cabinet.

purposes of taxation: not only can the shares themselves not be taxed, they cannot even be briefly exposed to other taxable assets of the same character in order to calculate a tax. We believe this is this an excessively extravagant extension of *St. Ledger*. We find nothing in the *St. Ledger* opinion which purported to affect KRS 136.020's use of stock in its formulas. As such, the principal underpinning of Monumental's argument is, we believe, based upon a misinterpretation of *St. Ledger*.

While we believe Monumental's misinterpretation of *St. Ledger* substantially defeats its arguments challenging the Cabinet's computation method, we next address whether the Cabinet properly applied KRS 136.020 in calculating the tax liability for the years 1991 through 1996. The version of KRS 136.020 in effect during the time period we are concerned with stated as follows:

> 1) Each life insurance company incorporated under the laws of and doing business in Kentucky shall value as of January 1 and report to the Revenue Cabinet by July 15, 1966, and by April 1 each year thereafter, on forms prescribed by the Revenue Cabinet, the following:
>
> (a) The fair cash value of the company's intangible personal property, hereinafter referred to as "capital," consisting of all money in hand, **shares of stock**, notes, bonds, accounts, and other credits, exclusive of due

and deferred premiums, whether secured by mortgage, pledge, or otherwise, or unsecured. [Emphasis added].

(b) The fair cash value of the company's intangible personal property exempt from taxation by law.

(c) The aggregate amount of company's reserves, reduced by the amount of due and deferred premiums, maintained in accordance with the applicable provisions of KRS 304.6-040 and 304.6-130 to 304.6-180, on all outstanding policies and contracts supplementary thereto.

(d) Such other information as may be required by the Revenue Cabinet to accurately determine the fair cash value of each company's "taxable capital" and "taxable reserves."

(2) Based on information supplied by each company and such other information as may be available, the Revenue Cabinet shall value each company's "taxable capital" and "taxable reserves" as follows:

(a) "Taxable capital" shall be determined by deducting "taxable reserves" from "capital," less exempt intangible personal property.

(b) "Taxable reserves" shall be determined by multiplying the aggregate amount of reserves as computed in subsection (1)(c) of this section by the percentage determined by dividing "capital," less exempt intangible personal property, by "capital," including exempt intangible personal property.

(3) An annual tax of seventy cents ($ 0.70) on each one hundred dollars ($100) of the fair cash value of "taxable capital" and one-tenth of one cent ($0.001) on each one hundred dollars ($100) of the fair cash value of "taxable reserves" shall be imposed for state purposes. The tax shall be in lieu of all excise, license, occupational, or other taxes imposed by the state, county, city, or other taxing district, except as provided in subsections (4), (5), and (6) of this section.

(4) The county in which the principal office of the company is located may impose a tax of fifteen cents ($0.15) on each one hundred dollars ($100) of "taxable capital."

(5) The city in which the principal office of the company is located may impose a tax of fifteen cents ($0.15) on each one hundred dollars ($100) of "taxable capital."

(6) The Revenue Cabinet shall by September 1 each year bill each company for the state

taxes. It shall immediately certify to the county clerk of the county in which the principal office of the company is located the value of "taxable capital" subject to local taxation. The county clerk shall prepare and deliver a bill to the sheriff for collection of taxes collectible by the sheriff and shall certify the value to all other collecting officers of districts authorized to levy a tax.

(7) Each company's real and tangible personal property shall be subject to taxation at fair cash value by the state, county, school, and other taxing districts in which such property is located in the same manner and at the same rates as all other property of the same class.

(8) Taxes on property subject to taxation under this section shall be subject to the same discount and penalties as provided in KRS 134.020 and shall be collected in the same manner as taxes on property locally assessed, except that the state tax on the "taxable capital" and "taxable reserves" shall be collected directly by the Revenue Cabinet.

(9) Any taxpayer subject to taxation under this section may protest in the manner provided in KRS 131.110.

The interpretation of a statute is a matter of law. *Commonwealth v. Garnett*, 8 S.W.3d 573, 575-6, 46 6 Ky.

L. Summary 9 (Ky.App. 1999). The primary purpose of judicial construction is to carry out the intent of the legislature. In construing a statute, the courts must consider "the intended purpose of the statute-and the mischief intended to be remedied." "A court may not interpret a statute at variance with its stated language." *SmithKline Beecham Corp. v. Revenue Cabinet*, 40 S.W.3d 883, 885 (Ky.App. 2001). The first principle of statutory construction is to use the plain meaning of the words used in the statute. *See Revenue Cabinet v. O'Daniel*, 153 S.W.3d 815 (Ky. 2005); KRS 446.080(4). "[S]tatutes must be given a literal interpretation unless they are ambiguous and if the words are not ambiguous, no statutory construction is required." *Commonwealth v/. Plowman*, 86 S.W.3d 47, 49 (Ky. 2002). We lend words of a statute their normal, ordinary, everyday meaning. *Id.* "We are not at liberty to add or subtract from the legislative enactment or discover meanings not reasonably ascertainable from the language used." *Commonwealth v. Harrelson*, 14 S.W.3d 541, 546 (Ky. 2000). The courts should reject a construction that is "unreasonable and absurd, in preference for one that is 'reasonable, rational, sensible and intelligent [.]'" *Commonwealth v. Kerr*, 136 S.W.3d 783, 785 (Ky.App. 2004); *Commonwealth v. Kash*, 967 S.W.2d 37, 43-44, 44 14 Ky. L. Summary 2 (Ky.App. 1997).

First, we note that KRS 136.020 expressly provides for the inclusion of "shares of stock" in the initial calculation of "capital." In this respect, it is treated the same as, for example, money, notes, and bonds. Thus the plain language of the statute supports the Cabinet's method and is adverse to Monumental's method.

Second, we believe the complete exclusion of stock from the calculations described in KRS 136.320, as proposed by Monumental, yields an illogical and absurd result. As previously discussed, at the times in issue the intangible assets of domestic life insurance companies were taxed at two different rates. "Taxable capital" was taxed at the rate of $0.70 per $100 (or to use terms more illustrative of the sums in issue here, $ 700,000 per $100 million) and its "taxable reserves" were taxed at the rate of $0.001 per $100 (or $1,000 per $100 million). While we need not get into the specific math, it is important to note that the method proposed by Monumental (the exclusion method) allocates more value to taxable reserves, whereas the Cabinet's method (the exemption method) allocates more to taxable capital. Thus it is not difficult to see why Monumental, or, indeed, any rational taxpayer would want to increase taxable reserves and decrease taxable capital. Because of the differential in tax rates, such allocation results in a lower tax liability.

Monumental's method, however, results in what we believe to be a manifestly illogical result. For example, under the method proposed by Monumental, its 1995 tax return would report total capital equal to *negative* $145 million. Such a result cannot be reconciled with the sort of logic one normally expects to find in tax statutes.

Moreover, if the situation is considered whereby two hypothetical domestic life insurance companies with the same dollar amount of "taxable capital," one with substantial stock holdings and the other with little or

no stock in its investment portfolio, the former would pay much less tax. Such disparate treatment would violate Section 171 of the Kentucky Constitution, which requires uniform taxation of all property within the same class. This difficulty is avoided entirely if stock is exempted rather than excluded in calculating the tax.

In addition, we believe the method used by the Cabinet follows the calculation procedures as set forth in KRS 136.020, and, to the extent the statute could be construed as ambiguous, the Cabinet's view is a reasonable interpretation of the statute it is charged with enforcing.

Alternatively, however, Monumental argues that the doctrine of contemporaneous construction requires the application of the exclusion method in the tax calculations under KRS 136.020. Monumental offers two reasons for this: first, because the Cabinet initially "accepted" this method in its audits of Monumental's 1997 and 1998 returns, and (2) because the Cabinet has used this method in relation to partnership interests and mutual funds.

> The doctrine of contemporaneous construction means that where an administrative agency has the responsibility of interpreting a statute that is in some manner ambiguous, the agency is restricted to any long-standing construction of the provisions of the statute it has made previously. Practical construction of an

> ambiguous law by administrative officers continued without interruption for a very long period is entitled to controlling weight.

GTE v. Revenue Cabinet, Com. of Ky., 889 S.W.2d 788, 792, 41 13 Ky. L. Summary 21 (Ky. 1994) (citation and internal quotation omitted).

The doctrine of contemporaneous construction has no application under the facts of this case. We cannot accept either that the Cabinet's acceptance of Monumental's method in its initial audits for a two-year period—which the Cabinet contends resulted from auditor error—amounted to a "construction" of the law, or that the two-year time frame during which the Cabinet "accepted" the method satisfies the requirement of a "long-standing" period of time within the meaning of the doctrine. *See Revenue Cabinet v. Lazarus, Inc.*, 49 S.W.3d 172 (Ky. 2001). Moreover, stock is distinguishable from partnership interests and mutual funds because stock is specifically listed in KRS 136.020 whereas partnership interests and mutual funds are not.

Under this argument heading Monumental also argues that the Board erred by excluding evidence concerning the Cabinet's policies to avoid double taxation in relation to partnership interests and mutual funds. Monumental sought to present the evidence in connection with its argument for the application of the contemporaneous construction doctrine. However, as noted above, KRS 136.020 is not concerned with partnership interests and mutual funds, and evidence

relating to those assets was accordingly not relevant to the issues at bar. Thus we do not believe the Board abused its discretion by disallowing the evidence.

WHETHER MONUMENTAL'S SEPARATE ACCOUNT ASSETS ARE SUBJECT TO TAX

Monumental argues that the Cabinet erred by assessing a tax liability against its "separate accounts" assets for the years 1995 through 1998. The separate account assets consist principally of retirement fund amounts held for distribution to retirees in the future.

Monumental and like companies are permitted to create separate accounts pursuant to KRS 304.15-390. The pertinent provisions of that statute provide:

> (1) A domestic life insurer may establish one (1) or more separate accounts, and may allocate thereto, in accordance with the terms of a written contract or agreement, any amounts paid to the insurer in connection with a pension, retirement or profit-sharing plan, life insurance, or an annuity which are to be applied to provide benefits payable in fixed or in variable dollar amounts or in both.
>
> . . . .
>
> (3) Assets allocated to a separate account shall be valued at their market value on the date of valuation, or if there is no readily

> available market, then in accordance with the terms of the applicable contract or agreement; except, that the portion of the assets of such separate account at least equal to the insurer's reserve liability with regard to the guaranteed benefits and funds referred to in subsection (1) of this section, if any, shall be valued in accordance with rules otherwise applicable to the insurer's assets.
>
> . . . .
>
> (6) Amounts allocated by domestic life insurers to separate accounts in the exercise of the power granted by this section shall be owned by the insurer and the insurer shall not be, or hold itself to be, a trustee, in respect to such amount.

KRS 136.320(1)(a) defines "capital" as "consisting of all money in hand, shares of stock, notes, bonds, accounts, and other credits, exclusive of due and deferred premiums, whether secured by mortgage, pledge, or otherwise, or unsecured." (Emphasis added). Upon the application of the plain language of the statute, the holdings booked into the "separate accounts" account clearly fall within the statutory definition. Monumental does not seriously dispute this but, rather, relies upon a variety of theories to shield the account from taxation.

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First, Monumental contends that the account is shielded from taxation based upon the doctrine of contemporaneous construction. Monumental underpins this argument by alleging that for over 20 years it has not reported this account for taxation purposes, the Cabinet audited those returns and accepted the exclusion of the account, and, therefore, the Cabinet has a long-standing construction of excluding the account from taxation. The Cabinet alleges, however, that it was never its policy to exclude holdings booked to the account but, rather, the substance of the account only came to light during the 1998 audit when Monumental finally provided an itemized listing of the assets booked to the account. The Cabinet faults Monumental for deficient reporting over the 20 or so past years and states that when it realized that the assets booked to the account were taxable, it immediately assessed current and back taxes. Contemporaneous construction cannot be asserted by a taxpayer to, in effect, create for itself an amnesty for a long period of failing to self-report taxable assets. "Mere nonaction upon the part of the officers of the state is not to be treated as contemporaneous construction. Nor can the Cabinet change the law through mistake." *Lazarus, Inc.*, at 175 (internal citation and quotation marks omitted).

Alternatively, Monumental contends that the account is not subject to taxation because it has no cash value. It alleges that it merely holds legal title to the assets booked to the account, but that the retirement/pension beneficiaries hold equitable title to the assets and that, therefore, the account assets are specifically

tied to a guaranteed benefit or payment in connection with pension retirement plans. It follows, Monumental alleges, that the assets have no value to tax.

As noted above, KRS 304.15-390(6) provides that [a]mounts allocated by domestic life insurers to separate accounts in the exercise of the power granted by this section shall be owned by the insurer and the insurer shall not be, or hold itself to be, a trustee, in respect to such amount." We believe that Monumental's position is inconsistent with the plain language of the statute.

We further note that KRS 136.020 provides no exception for retirement and pension assets. If the legislature sought to exclude such items, it could have easily said so.

While Monumental may raise a valid point in distinguishing pension and retirement funds from other types of accounts, it is not our function to set tax policy which is, in effect, what Monumental asks us to do. "To do such would be a complete violation of the separation of powers doctrine set forth in Kentucky's Constitution." *St. Ledger v. Com., Revenue Cabinet*, 942 S.W.2d 893, 898, 44 2 Ky. L. Summary 18 (Ky. 1997). For this Court to deem the retirement and benefit funds held by Monumental in its "separate accounts" account to be excluded from tax "would, in effect, be this Court delving into a realm our Constitution left squarely within the power of the Legislative Branch." *Id.* As such, we will not disturb the Cabinet's treatment of the account.

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As its third rationale for nontaxability of the account Monumental alleges that ERISA[9] Section 514(a) bars the imposition of an ad valorem tax on the account. Monumental does not cite us to its preservation of this issue as required by CR 76.12(4)(c). In its December 4, 2003, Order, the Board stated "[Monumental] failed to raise the issue of ERISA in its Petition of Appeal, or in any other pleading except its brief, including the pre-hearing compliance statement and the supplemental pre-hearing compliance statement. Therefore it failed to preserve this issue for review by this Board. The board will not consider the ERISA issue. *Stoner Creek Stud v. Revenue Cabinet*, Ky.App. 746 S.W.2d 73 (1987)." As we have otherwise not been cited to Monumental's proper preservation of the issue, we will likewise not address this argument on the merits. *Shelton v. Commonwealth*, 992 S.W.2d 849, 852, 45 10 Ky. L. Summary 2 (Ky.App. 1998).

As its final rationale for nontaxability of the account Monumental alleges that the back assessments were improper under the retroactivity provisions of KRS 132.290. More specifically, Monumental contends that KRS 132.290 permits only *omitted* property to be assessed retroactively, but that it reported the grand total of the account in its reporting forms, and therefore no retroactive assessments are permitted under the statute. KRS 132.290 provides, in relevant part, as follows:

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9. Employee Retirement Income Security Act of 1974. 29 U.S.C. § 1001. et. seq.

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> (1) . . . . Any personal property which has not been listed for taxation, for any year in which it is taxable, by the due date of that year shall be deemed omitted property.
>
> (2) All omitted property shall be assessed retroactively in the manner provided by law at any time within five (5) years from the date when it became omitted . . . .

The Board made the following findings relevant to this issue:

> A life insurance company such as Monumental is required to file an "Annual Statement" (sometimes referred to as a "Blue Book") with the Commonwealth of Kentucky Department of Insurance reporting its general account assets and liabilities, and, if applicable, an "Annual Statement of the Separate Accounts" (sometimes referred to as a "Green Book").
>
> Monumental reported the separate accounts as a single line item on their Blue books, but failed to list them on line 1 of their capital stock tax returns as capital, as required by KRS 136.320.
>
> The separate accounts, and accompanying detail, are listed in the Green Books, which are financial statements separate and apart from the Blue Book.

. . . .

> The Green Books, which detailed the separate accounts, were normally not provided to Revenue when the tax return and Blue Books were filed.[10]

In summary, the foregoing findings reflect that Monumental reported the grand total of the separate accounts account in its filings with the Cabinet, but failed to file the supporting subaccounts which would disclose to the Cabinet that items booked to the account were taxable. Most significantly, taxable items were not listed for KRS 136.320 taxation purposes. Thus, we believe the separate accounts account for the periods in question qualify as "omitted" under KRS 132.290, and, accordingly, the Cabinet properly applied the retroactivity provisions of the statute.

UNLAWFUL SINGLING-OUT OF MONUMENTAL

Monumental alleges that the Cabinet is singling them out for tax treatment in violation of Section 171 of the Kentucky Constitution, which requires uniformity in taxation. It argues that "*Post-St. Ledger*, the simple fact is that in a state of 4 million residents, only Monumental is being taxed on the value of its stock assets; a plain violation of uniformity."

Monumental does not cite us to its preservation of this issue as required by CR 76.12(4)(c), nor does it

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10. Citations to record omitted.

provide citations to any of the evidence in the record which allegedly supports this argument. Accordingly, we will not address this issue upon the merits.

ACCORD AND SATISFACTION

Monumental contends that the Cabinet's re-audits and tax liability assessments for the years 1995-1998 are barred by the doctrine of accord and satisfaction. It alleges that because following the initial audits the Cabinet "stated at the administrative protest(s) the amount it would accept in full payment of Monumental's obligation" was an accord, and Monumental's subsequent satisfaction of that amount by payment or tax credit was a satisfaction.

Under the doctrine of accord and satisfaction, "[a]n offer in satisfaction of a claim must be accompanied by an express condition that the acceptance is in full satisfaction of the claim and that the offeree takes the money subject to such condition. In lieu of an express condition, the circumstances must clearly indicate to the creditor that this condition is present." *Bruestle v. S & M Motors, Inc.*, 914 S.W.2d 353, 354 (Ky.App. 1996) (quoting *Rauch v. Shots*, 533 N.E.2d 193, 194 (Ind.Ct.App.1989)); *Liggons v. House & Associates Ins.*, 3 S.W.3d 363, 365, 46 3 Ky. L. Summary 6 (Ky.App. 1999).

We do not believe that the doctrine of accord and satisfaction is applicable under the facts of this case. KRS 132.290 sets forth by statute the procedures relevant to omitted property. The statute does not

prevent re-audits, and Monumental cites us to no authority which would prevent the procedures undertaken by the Cabinet to assess back taxes. As previously discussed, the Board found Monumental at fault for failing to report the underlying details of its separate accounts account and for failing to include applicable items in its KRS 136.320 filings. As the new information came to light, the Cabinet was, we believe, entitled to follow the statutory provisions contained in KRS 132.290 to assess back-taxes.

KRS 131.081

Monumental contends that the assessment of deficiency interest added to the assessed tax for the years 1995-1998 must be abated pursuant to KRS 131.081(8), a part of the "Tax Payers' Bill of Rights." It alleges that "KRS 131.081(8) . . . automatically abates penalties and interest which arise due to a taxpayer's reasonable reliance on written advice received from the Cabinet."

Though KRS 131.081 was amended in 1998, 2000, 2005, and 2006, Section (8) has provided throughout this period as follows:

> (8) The department shall include with each notice of tax due a clear and concise description of the basis and amount of any tax, penalty, and interest assessed against the taxpayer, and copies of the agent's audit workpapers and the agent's written narrative

> setting forth the grounds upon which the assessment is made. Taxpayers shall be similarly notified regarding the denial or reduction of any refund or credit claim filed by a taxpayer.

The provision does not appear to address the issue of interest and penalty abatement. In any event, Monumental does not cite us to the written advice from the Cabinet it relied upon in failing to properly report its separate accounts in its filings. Hence we are unpersuaded by this argument.

CONCLUSION

For the foregoing reasons the judgment of the Franklin Circuit Court is affirmed.

BUCKINGHAM, SENIOR JUDGE, CONCURS.

THOMPSON, JUDGE, DISSENTS AND FILES SEPARATE OPINION.

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THOMPSON, JUDGE, DISSENTING: I respectfully dissent. I have no doubt that the Kentucky legislature has repealed taxation on stock owned by shareholders of corporations, which includes Monumental. In addition, the taxation of Monumental's separate account is repugnant to basic principles of taxation. The separate account consists of pension funds and annuities placed in the account by Monumental on behalf of the plan participants. Because the Legislature has abolished taxes on the value of stock held by shareholders in this state, each of these tax computations are a direct or indirect taxation of shareholders.

Initially, I believed the trial court utilized an improper method to review the findings of the administrative agency herein. The trial court erroneously applied the substantial evidence standard of review to all issues raised by the parties. The issues raised are questions of law, fact, or mixed questions of law. As to the questions of law, when an issue is purely one of interpretation of law or presents a mixed question of law and fact, our review is de novo. *Epsilon Trading, Inc. v. Revenue Cabinet*, 775 S.W.2d 937 (Ky.App. 1989).

As the majority recognizes, *St. Ledger* involved the commerce clause and KRS 132.020. However, our Supreme Court provided further analysis and reaffirmed the expressed public policy of the Commonwealth against double taxation as it applies to taxation of a corporation and its shareholders. Although there is no constitutional provision forbidding double

taxation, public policy dictates that taxation of the same property twice not be enforced except in cases where the legislature has clearly declared a contrary policy. *City of Louisville v. Aetna Fire Ins. Co.*, 284 Ky. 154, 143 S.W.2d 1074 (1940). So strong is the public policy that if the legislative intent is less than clear, a "statute should be construed so as to avoid double taxation in any form." *Kentucky Power Company v. Revenue Cabinet*, 705 S.W.2d 904 (Ky. 1985).

I am convinced that the legislature has, without exception, re-affirmed its intent to avoid double taxation of our citizens. *Post-St. Ledger*, the exemption statute was repealed and reference to stock deleted from KRS 132.020. In doing so, it must be presumed that the legislature was aware of the *St. Ledger* decision. *St. Clair v. Commonwealth*, 140 S.W.3d 510 (Ky. 2004). Although it could have equally taxed both in-state and out-of-state corporations and their shareholders, the legislature chose to eliminate the tax on shareholders on the value of their corporate shares and adhere to this Commonwealth's public policy against double taxation.

The majority believes the Supreme Court's opinion was limited strictly to KRS 132.020 but I am not persuaded. Our highest Court's intent was to declare all ad valorem taxes on the ownership of corporate shares forbidden unless the legislature clearly states to the contrary. If, as the majority suggests, our judicial opinions are limited to the facts presented without bearing on future cases, our law is destined to stagnation and no longer a moving stream guided in its

journey by precedent. *See Hilen v. Hays*, 673 S.W.2d 713, 718 (Ky. 1984).

Applying the mathematical computation performed by the Cabinet, Monumental's stock was not merely "exposed" to taxable assets; it was transformed into a taxable asset. The majority ignores the testimony of the lone expert, Professor Richard Pomp, who affirmatively testified that the exemption method used by the Cabinet resulted in the taxation of stock. He explained:

> If this were as simple as on line one you include the shares and on line 2 you exclude the shares then obviously you have eliminated the effect of the shares. But that is not what is going on here at all. The calculation is much more complicated that that. And because of the complication, excluding the shares has a different impact from exempting the shares. Excluding the shares means taking the shares out of the calculation entirely. Exempting means treating them wherever the word exempt appears in the formula as being put in that part of the process, that step in the formula.
>
> And whether you treat it as excluded or you treat it as exempt, mathematically it has a very different effect. That's the first part of this case.

> And, therefore, it really follows as a matter of logic that if you exclude the shares, you get a lower tax. But if you exempt the shares and you get a higher tax, then the exemption is a way of indirectly taxing the shares. The exemption does not have a neutral effect in this case. It does lead to a higher tax compared to excluding the shares.

An applicant before an administrative agency bears the burden of proof and must provide sufficient evidence to establish a prima facie case for the relief sought. *See City of Louisville, Div. of Fire v. Fire Service Managers Assoc. ex rel. Kaelin*, 212 S.W.3d 89, 94 (Ky. 2006); *Danville-Boyle County Planning and Zoning Commission v. Prall*, 840 S.W.2d 205 (Ky. 1992). However, Monumental established through the testimony of Professor Pomp that it was entitled to the relief sought, and the Cabinet elected not to introduce any expert testimony.

In reliance on the sole expert testimony, I believe that the majority's understanding of this rather complex computation is amiss and is unsupported by evidence in the record. There is an undesirable consequence of including stock in the tax computation: a portion of taxable reserves is shifted to taxable capital when the stock is exempted rather than excluded. Because of the difference in the tax rates under the statute, the exemption method results in a substantially higher tax. Indeed, if there were no difference in the tax consequences if either method were used, there would be no controversy.

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The majority states in its opinion that following the finality of *St. Ledger*, Monumental adopted the position that all stock assets should be excluded from the ad valorem tax calculations imposed under KRS 136.320. This statement is in error. Before *St. Ledger*, Monumental and the Cabinet adopted the position that all stock assets should be excluded from ad valorem tax calculations. It was only after *St. Ledger* that the Cabinet adopted the position that stock assets should be included in the ad valorem tax calculations imposed under KRS 136.320.

Although KRS 136.320 does not impose a direct tax on stock, the majority's interpretation permits an indirect tax that is equally offensive. A state cannot tax indirectly that which it cannot tax directly. *See Square D Co. v. Kentucky Board of Tax Appeals*, 415 S.W.2d 594, 599 (Ky. 1967). Thus, I would hold that to avoid double taxation, shares of stock must be excluded rather than exempted, under KRS 136.320.

The majority recites that the result of excluding shares is illogical. I disagree. Both state and federal tax laws permit taxpayers to allocate assets into non-taxable sources. Two common situations support my statement. While two taxpayers may own the same amount of assets, one may own more non-taxable bonds. Likewise, two citizens may earn the same income yet one pays lower taxes because of contributions to retirement accounts, depreciation of real estate, interest expenses, etcetera.

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I am also in disagreement with the majority's reasoning and result regarding the taxation of the separate account. In my opinion, this once again constitutes double taxation.

A purchaser of an annuity or a contributor to a pension plan has paid taxes or has deferred the payment of taxes on the funds invested in the annuity or pension plan. These funds are placed into the care and custody of Monumental Insurance Company. To again tax these funds as an asset of Monumental Insurance Company constitutes double taxation of the participant in the retirement plan or annuity and diminishes the income to that third party by the taxation of the account.

If an individual desires to establish a pension plan and places his pension plan into the trust of his stockbroker or his bank and designates that shares of stock be purchased by his pension plan for his retirement, those shares will not be taxed. However, if that same person were to invest his pension plan with Monumental who utilizes their expertise to invest shares of stock on his behalf for his retirement, then his shares will be taxed. This is unequal taxation and in direct violation of the legislature's mandate that the value of the possession of shares of stock not be taxed.

The majority places blame on Monumental for its failure to report the assets. The facts, however, demonstrate that Monumental did not pay taxes on the separate account because the Cabinet deemed the account not to be taxable. The majority ignores what I consider to be the crucial facts.

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Professor Pomp testified that separate accounts are similar to reserves in that the assets in the accounts are not operating capital but are held for the payment of retirement benefits.

Dennis Van Meighem is a specialist in the taxation of insurance companies. He testified that a separate account is a segregated account, distinct from the company's liabilities and assets. The records of the account are kept in a "green book" and all gains and losses are allocated solely to that account. A separate account is distinctive in the respect that its liabilities are always equal to its assets. Any gains from the account are transferred to the company's "blue book" which reflects the company's operating capital. As a result, there is no net worth attributable to a separate account. The legal owner of the assets is the insurance company, which has the ability to execute investment decisions but the equitable owner is the contract holder; the third party participant in the pension plan or the annuity.

Colleen Lyons, who was employed by Monumental in the tax department from 1984 through 1998, testified that in preparation for the company's capital stock tax return, she did not include the company's separate account and had never received any notice from the Cabinet that it considered separate accounts taxable.

Nancy Moore Marshall testified to facts relevant to the Cabinet's treatment of separate accounts for the purpose of calculating capital stock tax. From 1980 through 1998, she worked in the division of the Cabinet

that mandated the capital stock tax. During those eighteen years, she was unaware of the Cabinet taxing any separate accounts.

James Livers testified that in the 1980's or 1990's the issue arose as to whether separate accounts should be included in the capital stock tax. Apparently, the issue was affirmatively resolved and the tax was applied to at least one taxpayer. However, there was no documentation to support his recollection. Mr. Livers excused the Cabinet's failure to previously impose a tax on Monumental's separate account to an oversight by the Cabinet.

I also do not believe that because KRS 304.15-390 designates the insurer as the "owner" of the separate account, the assets are necessarily taxed under KRS 136.620. KRS 136.320(1) requires that an insurance company report the fair cash value of "all money in hand, shares of stock, notes, bonds, accounts, and other credits . . . ." "Fair cash value" is the value of the property to a buyer who "would obtain by his purchase the same interest held by the seller, and would also obtain thereby all of the rights of the seller." *Commonwealth ex. Rel. Reeves v. Sutcliffe*, 287 Ky. 809, 155 S.W.2d 243, 245 (Ky. 1941).

Applying the definition to this case, even if the separate account could be sold, a buyer of Monumental's interest would obtain only legal title and not the value of the assets. This distinction was noted in *Kentucky Power Co. v. Revenue Cabinet*, 705 S.W.2d 904 (Ky. 1985),

wherein the Court recognized that legal title and equitable title have different monetary values. When legal and equitable title are separated the "legal interest is virtually worthless because of itself it owns nothing and can exercise no control over the property." Id. at 905.

The title vested in Monumental is solely for the purpose of managing the investments in the account for the benefit of the equitable title holders, the retirement/ pension beneficiaries. As revealed by the expert testimony, Monumental cannot fund its operating capital from the assets or otherwise pay its debt from that source. A buyer would receive nothing more. In a similar situation, if Monumental were to enter into a bankruptcy, these accounts would not constitute an asset of the bankruptcy estate. Similarly, if a creditor obtained a judgment against Monumental, they could not execute or attach these separate accounts to collect their judgment. Thus, the specification of Monumental as the owner of the separate account does not include it within the ambit of KRS 136.320.

Moreover, absent from KRS 136.320 is any reference to separate accounts. Although separate accounts may consist of cash, stock, bonds and other intangibles, it is obvious from the legislature's enactment of KRS 304.15-390 that it recognized a separate account as a distinct financial unit unique to domestic life insurers. Thus, it is reasonable to construe the statute in a way to exclude separate accounts.

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Until Monumental filed its protest claiming a refund substantially higher than that calculated by the Cabinet, it had never been taxed on its separate account assets. Although its green book was not submitted with its return on an annual basis, Monumental provided its blue book which advised the Cabinet of its separate account retirement assets. Yet, the Cabinet consistently failed to request that Monumental submit its green book or any other documents detailing the contents of its separate account. For over twenty years, which included audit years, the Cabinet never questioned the omission of the separate account.

In my opinion, the actions of the Cabinet have a strong implication of retaliation and the contentious proceedings before the Board constitutes arbitrary conduct toward Monumental.

In conclusion, I would reverse the decision of the circuit court and remand the case to the Cabinet for a calculation of the Monumental's refund based on the exclusion of its stock assets, plus any interest owed. I would further hold that the Cabinet cannot tax Monumental's separate account.

APPENDIX B — OPINION AND ORDER OF THE COMMONWEALTH OF KENTUCKY, COURT OF APPEALS DATED AUGUST 18, 2006

COMMONWEALTH OF KENTUCKY
COURT OF APPEALS

NO. 2005-CA-002148-MR

MONUMENTAL LIFE INSURANCE COMPANY (SUCCESSOR IN INTEREST TO COMMONWEALTH LIFE INSURANCE COMPANY),

APPELLANT

v.

THE DEPARTMENT OF REVENUE (FORMERLY KNOWN AS THE REVENUE CABINET); THE KENTUCKY BOARD OF TAX APPEALS; AND LOUISVILLE/JEFFERSON COUNTY METRO GOVERNMENT (FORMERLY KNOWN AS CITY OF LOUISVILLE, KENTUCKY AND JEFFERSON COUNTY, KENTUCKY),

APPELLEES

OPINION AND ORDER

BEFORE: ABRAMSON, TAYLOR, AND VANMETER, JUDGES.

Appendix B

VANMETER, JUDGE: This matter is before us upon Monumental Life Insurance Company's motion to remand the administrative record to the Kentucky Board of Tax Appeals (KBTA) for proper organization and indexing. The Revenue Cabinet opposes the motion. After reviewing the relevant facts and legal authority, we grant the motion.

The KBTA is an "administrative review agency" (Kentucky Revised Statutes (KRS) 131.310) endowed with exclusive jurisdiction over certain appeals from rulings and orders affecting revenue and taxation (KRS 131.340). An administrative hearing before the KBTA "shall be de novo and conducted in accordance with KRS Chapter 13B." KRS 131.340(1).

KRS 13B.130 requires an administrative agency, such as the KBTA, to maintain an official record of the proceedings:

> In each administrative hearing, an agency shall keep an official record of the proceedings which shall consist of:
>
> (1) All notices, pleadings, motions, and intermediate rulings;
>
> (2) Any prehearing orders;
>
> (3) Evidence received and considered;
>
> (4) A statement of matters officially noticed;

(5) Proffers of proof and objections and rulings thereon;

(6) Proposed findings, requested orders, and exemptions;

(7) A copy of the recommended order, exceptions filed to the recommended order, and a copy of the final order;

(8) All requests by the hearing officer for an extension of time, and the response of the agency head;

(9) Ex parte communications placed upon the record by the hearing officer; and

(10) A recording or transcript of the proceedings.

KRS 13B.130. For the reasons hereinafter elucidated, we interpret KRS 13B.130 as impliedly requiring an administrative agency to create and maintain a complete and orderly official record of the proceedings that is readily capable of review.

It is axiomatic that construction and interpretation of a statute is a matter of law for the court. *City of Worthington Hills v. Worthington Fire Protection Dist.*, 140 S.W.3d 584 (Ky.App. 2004). When interpreting a statute, the court recognizes that a statute need not

expressly state that which is necessarily implied. *Nat'l Surety Co. v. Com. ex rel. Coleman*, 253 Ky. 607, 69 S.W.2d 1007 (1934).

KRS 13B.130 explicitly requires an administrative agency to keep an "official record" comprised of specific documents and materials. By expressly mandating such an official record, the General Assembly clearly intended that the record be organized in a manner readily capable of review. This is especially true considering the importance of the administrative record to both the administrative process and to judicial review. Simply put, a record lacking coherent organization evades meaningful administrative and judicial review.

Accordingly, we interpret KRS 13B.130 as implicitly requiring an administrative agency to create and maintain a complete and orderly official record of the proceedings that is readily capable of review. To hold otherwise would render hollow the statutory mandate to keep an official record.

In this appeal, the administrative record is comprised of six boxes of various documents and materials and includes both copies and originals without differentiation. These documents and materials are arranged in no particular order, and there is no index or other content listing of same. Without a content index, it is impossible to discern whether the administrative record is even complete.

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While it is generally appellant's responsibility to ensure an adequate record for judicial review, the statutory duty of an administrative agency to provide a complete and orderly official record is manifestly paramount. Here, the KBTA failed to create and maintain an official record as mandated by KRS 13B.130.

Therefore, the Court ORDERS that Monumental Life's motion to remand the administrative record to the KBTA be GRANTED. We remand for the limited purpose of directing the Franklin Circuit Court to order: (1) the Clerk of the Franklin Circuit Court to return the administrative record to the KBTA; (2) the KBTA to properly compile the administrative record in an organized manner that renders it readily capable of review;[1] and (3) the KBTA to transmit a properly organized administrative record to the Franklin Circuit Court Clerk within ninety (90) days of entry of the circuit court's order.

Pending transmittal of a properly organized administrative record to the Franklin Circuit Court Clerk, the Court further ORDERS Appeal No. 2005-CA-002148-MR to be held in ABEYANCE. Additionally, the Clerk of the Franklin Circuit Court is hereby ORDERED to notify this Court upon receipt of the KBTA's record. In addition to the parties, we also ORDER the Clerk of the Court of Appeals to give due notice of entry of this

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1. We observe the compilation of a circuit court record could serve as an example of a properly organized official administrative record. *See* Ky. R. Civ. P. (CR) 98(3); CR 76.25(5).

Appendix B

Opinion and Order by mailing a true copy thereof to the Clerk of the KBTA and to the Chairman of the KBTA.

ALL CONCUR.

ENTERED: August 18, 2006

/s/ Laurance B. VanMeter
JUDGE, COURT OF APPEALS

APPENDIX C — ORDER AND OPINION OF THE COMMONWEALTH OF KENTUCKY, FRANKLIN CIRCUIT COURT DATED SEPTEMBER 22, 2005

COMMONWEALTH OF KENTUCKY
FRANKLIN CIRCUIT COURT
DIVISION I
CASE NO. 03-CI-01652

MONUMENTAL LIFE INSURANCE COMPANY
(successor in interest to COMMONWEALTH LIFE INSURANCE COMPANY)

PETITIONER/APPELLANT

v.

REVENUE CABINET, COMMONWEALTH OF KENTUCKY, et al.

and

JEFFERSON COUNTY, KENTUCKY

and

CITY OF LOUISVILLE, KENTUCKY

RESPONDENTS/APPELLEES

ORDER & OPINION

The Petitioner/Appellant, Monumental Life Insurance Company ("Monumental"), appeals the Final Order of the Kentucky Board of Tax Appeals ("KBTA"), which denied Monumental's Capital Stock Tax refund claims for the period of January 1, 1990, through

December 31, 1996. Monumental also appeals from the KBTA's denial of its request for relief from additional Capital Stock Tax assessments issued by the Revenue Cabinet, City of Louisville, and Jefferson County for the period January 1, 1995 through December 31, 1998. This Court has reviewed the record, the arguments of the parties and applicable law. The Court now **DENIES** the appeal.

INTRODUCTION

Monumental is a domestic life insurance company conducting business within the Commonwealth of Kentucky. As a result, it is subject to the Capital Stock Tax statute, KRS 136.320, which requires it to pay an annual property tax on its "taxable capital" and its "taxable reserves." This case raises two issues concerning the calculation of KRS 136.320. The first issue is whether stock is classified as exempt or excluded property.[1] The second issue is whether Monumental's "Separate Accounts" should be properly excluded from taxation.[2]

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1. Under the taxing scheme of KRS 136.320, subsection 2 requires that exempt intangible personal property be considered in the calculation of "taxable reserves" which are taxed at one tenth of one cent ($.001) per hundred dollars ($100). These "taxable reserves" are then considered in the calculation of "taxable capital", which is taxed at a rate of seventy cents ($.70) per hundred dollars ($100). Therefore, Monumental would like the stock it holds to be classified as excluded so that it may be omitted entirely from the above calculations.

2. "Separate Accounts" are addressed in KRS 304.15-390, which allows domestic life insurance companies to maintain (Cont'd)

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These issues were raised before the KBTA. A final order was issued in December of 2003, which upheld the Respondent's, Revenue Cabinet ("Cabinet"), position and ordered that the stock be exempted, not excluded. Also, the KBTA determined that separate accounts are assets belonging to Monumental and were therefore subject to a property tax.

STANDARD OF REVIEW

KRS 131.370[3] governs the judicial review of revenue cases. Because this statute incorporates Chapter 13B in its entirety, KRS 13B.150(2) is applicable to this case. Under KRS 13B.150(2), the Court may not substitute its judgment for that of the agency and may reverse an order in whole or in part *only* if it finds the order to be:

> (a) In violation of constitutional or statutory provisions;
>
> (b) In excess of the statutory authority of the agency;

(Cont'd)
these accounts and deposit into these accounts amounts paid into the insurer's pension, retirement or profit sharing plans, life insurance or annuity in accordance with a written contract.

3. KRS 131.370. provides that, "Any party aggrieved by any final order of the Kentucky Board of Tax Appeals . . . may appeal to the Franklin Circuit Court . . . in accordance with KRS Chapter 13B."

(c) Without support of substantial evidence on the whole record;

(d) Arbitrary, capricious or characterized by abuse of discretion; . . . or

(g) Deficient as otherwise provided by law.

Monumental argues that the Court should consider this case de novo pursuant to the Court of Appeals' decision in *Epsilon Trading Company, Inc. v. Revenue Cabinet*, 775 S.W.2d 937, (Ky. App. 1989). Monumental claims that under *Epsilon* the Court may avoid these restraints and review the case in full so long as the key evidentiary issues are not in dispute.

Monumental is correct in its analysis that in *Epsilon* the Court of Appeals removed the constraints of the substantial evidence rule and allowed the circuit court to fully review the KBTA's order. However, in *Epsilon*, there were *no* facts in dispute and the *sole* issue before the Court of Appeals was the interpretation of the applicable statute. The instant case is distinguishable; at the very least there are factual disputes as to the reasons underlying the Cabinet's audit[4] and whether or not Monumental ever listed its separate accounts for taxation[5]. As a result, this case does not qualify for the

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4. See Appellee's brief at page 6 and Appellant's Brief page 33.

5. See Appellee's brief at page 55 and Appellant's Brief at page 11.

treatment afforded *Epsilon* and the Court is not free to engage in a de novo review of the agency's action.

In McManus v. Kentucky Retirement Systems, 124 S.W.3d 454 (Ky. App. 2004), the Court of Appeals recognized that the allocation of the burden of proof in an administrative appeal will affect the standard to be used by the reviewing court. In doing so, the Court interpreted KRS 13B.090(7)[6], the section of the Administrative Procedure Act that addresses the appropriate burdens of proof. This approach is applicable to this case because the relevant statute, KRS 131.370, incorporates Chapter 13B in its entirety. As a result, it is necessary to determine which party bore the burden of proof at the administrative hearing.

Because Monumental asked the Cabinet to issue a refund, they were "the party proposing the agency take

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6. "In all administrative hearings, unless otherwise provided by statute or federal law, the party proposing the agency take action or grant a benefit has the burden to show the propriety of the agency action or entitlement to the benefit sought. The agency has the burden to show the propriety of a penalty imposed or the removal of a benefit previously granted. The party asserting an affirmative defense has the burden to establish that defense. The party with the burden of proof on any issue has the burden of going forward and the ultimate burden of persuasion as to that issue. The ultimate burden of persuasion in all administrative hearings is met by a preponderance of evidence in the record. Failure to meet the burden of proof is grounds for a recommended order from the hearing officer."

action or grant a benefit" and therefore bore the burden of showing that it was proper for the agency to issue such a refund.[7] The Cabinet, which was the fact finder at the administrative hearing, made the decision to deny Monumental the refund. Therefore, before the Court can overturn the Cabinet's decision, *McManus* requires that the Court find that, "the evidence in [Monumental's] favor is so compelling that no reasonable person could have failed to be persuaded by it." *McManus* at 459. Furthermore, "In its role as finder of fact, an administrative agency is afforded great latitude in its evaluation of the evidence heard and the credibility of the witnesses, including its findings and conclusions of fact." *Aubrey v. Office of Attorney General*, 994 S.W.2d 298, 309 (Ky. App. 1972). Likewise, this Court may not substitute its own judgment as to the inferences to be drawn from the evidence of record for that of the administrative agency. See *Railroad Comm'n v. Chesapeake & Ohio Ry.*, Ky., 490 .S.W.2d 763, 766 (1973). The function of this Court in administrative matters "is one of review, not of reinterpretation." *Kentucky Unemployment Ins. Comm'n v. King*, 657 S.W.2d 250, 251 (Ky. App. 1983)

DISCUSSION

Monumental has presented the Court with one overriding issue, the correct calculation of the Capital Stock Tax. This calculation hangs upon two underlying

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7. KRS 13B.090(7).

issues, the proper classification of stock for tax purposes and the legal owner of Monumental's separate accounts.

A. Classification of Stock

The first issue to be addressed is whether or not stock is classified as exempt or excluded property under the calculations of the Capital Stock Tax, KRS 136.320. The Cabinet contends and the KBTA agrees that the statute treats stock as exempt property ("Exemption Theory"). Monumental, on the other hand, argues that stock should be excluded ("Exclusion Theory") as intangible personal property. The result is that the parties have presented the Court with competing theories of the Capital Stock Tax, the Exclusion and the Exemption Theories. It is the role of this Court to determine whether the evidence in favor of the Exclusion Theory is so compelling that no reasonable person could have chosen to apply the Exemption Theory. The evidence in the record simply does not rise to this standard.

In its brief, the Revenue Cabinet demonstrated that the Exclusion Theory leads to an illogical result. For example, if this theory is used, Monumental's total taxable reserves equal more than its total taxable value of capital ("TTVC"). Brief for Appellee, p. 14. This results in one hundred five percent (105%) of Monumental's TTVC being taxed at the reserves rate of one-tenth of one cent ($.001) per one hundred dollars ($100). *Id.* It also makes its total taxable capital-nonreserves, which are taxed at the much higher rate

of seventy cents ($.70) per one hundred dollars ($100), negative one hundred forty million dollars (- $140,000,000.) *Id.* Given that the capital/nonreserves are the funds that are intended to be used to actually operate the business, this is at best an illogical result. It is a well-established rule of statutory construction that a statute may not be interpreted in a way that leads to an absurd or unreasonable result. *City of Frankfort v. Triplett*, 421 S.W.2d 328, 330 (Ky. 1963); *Hamilton v. Int'l. Union of Operating Engineers*, 262 S.W.2d 695, 699 (Ky. 1953); *George v. Alcoholic Beverage Control Bd.*, 421 S.W.2d 569, 571 (Ky. 1965). As a result, it is highly likely that a reasonable person would choose not to apply the Exclusion Theory. Therefore, this Court will defer to the Cabinet's interpretation of their own statute and support its decision to apply to the Exemption Theory.

Additionally, the KBTA held that exempting stock from the Capital Stock Tax calculations does not result in indirect taxation. The Cabinet performed the statutorily required calculation twice, treating stock as taxable capital in one calculation and as exempted property in the next. The result showed that despite whether the amount of stock was completely excluded or the tax liability attributable to the stock was subtracted from the total liability, the total tax bill was reduced by the same amount. Brief for Appellee, p. 17-18. KBTA Order, p. 7. Therefore, the Cabinet argues that the stock was not taxed. Furthermore, if the stock is not taxed, then it is impossible to agree with Monumental's argument that stock is subject to a double tax. The KBTA agreed with the Cabinet and this Court

finds that there is substantial evidence to support that conclusion. More importantly, the Court finds that there is no compelling evidence that would lead a reasonable person to question the KBTA's calculations.

Furthermore, Monumental cited the decision in *St. Ledger v. Revenue Cabinet, Ky.*, 942 S.W. 2d 893 (1997), in support of its argument that the tax was unconstitutional. However, *St. Ledger* was appropriately distinguished by the KBTA. *St. Ledger* dealt with the constitutionality of KRS 136.030(1) in light of evolving Commerce Clause jurisprudence. There is no language in the opinion that indicates that this decision was intended to exempt stock from every form of taxation. The only portions of *St. Ledger* that could potentially be extended to the case at hand are the statements concerning double taxation, however, as stated above, in this case the stock was not taxed and as a result cannot possibly be doubly taxed.

B. Legal Ownership of Monumental's Separate Accounts

Separate Accounts are addressed in KRS 304.15-390[8]. Subsection (1) of this statute allows companies like Monumental to create these accounts.[9] The statute goes on to say that these accounts are "owned by the insurer

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8. Titled, "Pension, retirement, profit-sharing, life insurance or annuity agreements – Separate Accounts."

9. "A domestic life insurer may establish one (1) or more separate accounts, and may allocate thereto, in accordance with (Cont'd)

and the insurer shall not be or hold itself to be, a trustee, in respect to such accounts."[10] This statute establishes through clear and unambiguous language that the insurer, in this case Monumental, is the legal owner of the Separate Accounts. As a result, Monumental, as the legal owner of the assets on the day the assessment was due, is liable for the tax due on these accounts.

Monumental goes on to argue that regardless of who owns these accounts, the actual value of the accounts is zero and as a result no taxes are actually owed. In order to value property for the purposes of taxation, the fair cash value of the property must be determined. *Commonwealth ex rel. Reeves v. Sutcliffe*, 155 S.W.2d 243, 245 (Ky. 1941). Monumental arrives at its value of zero by arguing that these accounts are not freely alienable. In other words, because these accounts represent customer's pensions and retirement accounts a buyer would not be free to liquidate the assets. However, this is a misinterpretation of the idea of fair cash value. This value is intended to represent what the property would be worth to a buyer who would acquire

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(Cont'd)
the terms of a written contract or agreement, any amounts paid to the insurer in connection with a pension, retirement or profit sharing plan, life insurance, or an annuity which are to be applied to provide benefits payable in fixed or variable dollar amounts or in both."

10. KRS304.15-390(6).

the same rights in the property as the seller.[11] Therefore, the assets are not worthless because under the standard the value assigned reflects the buyer's ability to derive the same financial benefits from the accounts as Monumental does. The Cabinet valued the separate accounts at the amount that Monumental assigned to them in their "Annual Statement of the Separate Accounts" or "Green Book." There is nothing in the record to contradict this value.

CORRECT APPLICATION OF LAW

This Court finds that the KBTA's decision is supported by substantial evidence, specfically, that the evidence in Monumental's favor is not so compelling as to preclude a reasonable person from ruling against them. The KBTA correctly reviewed Monumental's protest and ruled that *St. Ledger* has no impact on KRS 136.320. The KBTA correctly affirmed the Revenue Cabinet's calculation of Monumental's capital stock tax consistent with the statutory language and intent of KRS 136.320.

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11. "The intention as expressed in section 172 of our Constitution was to evaluate property for taxation according to its fair cash value, *if* the purchasers could or would obtain by his purchase *the same* interest held by the seller, and would also obtain thereby all of the rights of the seller." *Sutcliffe* at 245.

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CONCLUSION

This Court determines that the KBTA's decision represents a correct application of law and is supported by substantial evidence from the record as a whole; thus, the Court finds that the KBTA's decision was not arbitrary, capricious, or characterized by an abuse of discretion under KRS 13B.150(2)(b). Accordingly, the KBTA's Final Order is **AFFIRMED** and the appeal is **DISMISSED.**

SO ORDERED this 22 day of September 2005.

There being no just cause for delay, this is a final and appealable order.

s/ Roger L. Crittenden
Roger L. Crittenden
Judge, Franklin Circuit Court

APPENDIX D — ORDER OF THE COMMONWEALTH OF KENTUCKY, KENTUCKY BOARD OF TAX APPEALS DATED DECEMBER 4, 2003

COMMONWEALTH OF KENTUCKY
KENTUCKY BOARD OF TAX APPEALS
FILE NO. K00-R-23

MONUMENTAL LIFE INSURANCE COMPANY
(successor in interest to COMMONWEALTH LIFE INSURANCE COMPANY)

APPELLANT

v.

COMMONWEALTH OF KENTUCKY, REVENUE CABINET

and

JEFFERSON COUNTY, KENTUCKY

and

CITY OF LOUISVILLE, KENTUCKY (N/K/A LOUISVILLE/JEFFERSON COUNTY METRO GOVERNMENT)

APPELLEES

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ORDER NO. K-19052

A hearing in this appeal was conducted before the Kentucky Board of Tax Appeals. The parties have presented testimony and filed briefs. The Board enters the following order on the appeal.

FINDINGS OF FACT

This is an appeal by Monumental Life Insurance Company, successor in interest to Commonwealth Life Insurance Company of (i) the denial of its refund claim for capital stock tax for the periods January 1, 1990 through December 31, 1996, and (ii) the assessment of capital stock tax for the periods January 1, 1995 through December 31, 1998 by the Kentucky Revenue Cabinet.

This refund claim depends on whether Revenue correctly calculated the capital stock tax pursuant to KRS 136.320, after the holding in *St. Ledger v. Revenue Cabinet, Ky.*, 942 S.W.2d 893 (1997). Revenue included stock in capital pursuant to the statutory language, and then exempted it in calculating the capital stock tax. Monumental argues that despite the statutory language supporting exempting the stock in the process of calculating the tax, the stock should be completely excluded before the capital stock tax calculation is made. The Board disagrees.

Prior to *St. Ledger*, Revenue included stock as capital, but only treated those stocks that were covered by KRS 136.030 as exempt intangible personal property. (TE, pp. 224-25)

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For the period at issue, Monumental owned stock that had not qualified for treatment as exempt intangible personal property pursuant to KRS 136.030 prior to *St. Ledger.*

Monumental timely filed protective refund claims, beginning in 1991, with Revenue so if KRS 136.030(1) was held unconstitutional by *St. Ledger* and refunds were ordered, Monumental would be protected. (Stip. 10-12)

After the Supreme Court decision in *St. Ledger,* Revenue exempted all stock as exempt intangible personal property. Pursuant to the Exemption Theory, Revenue issued refunds to Monumental on the taxes it had paid pursuant to KRS 136.320 for the years 1990 through 1996 in the amount of $1,470,357.40.

After receiving the refund, Monumental timely protested Revenue's position on the amount of the refund, claiming it was entitled to an additional $6,751,758.46. Monumental's basis for this additional refund claim was that the stock must be excluded entirely when calculating capital stock tax. (Stip. 16)

Monumental's Exclusion Theory fails because Net Reserves must be allocated its proportionate share of the stock.

Monumental's Exclusion Theory will actually require allocation of more than 100% of Total Taxable Value of Capital to Taxable Reserves and negative Taxable Capital in some cases.

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Monumental's Exclusion Theory results in different tax liability for two taxpayers who own the same amount of taxable assets, but one also owns some stock, which is excluded, while the other does not.

How Revenue has elected to treat partnership interests or other intangible personal property that are not mentioned in KRS 136.320 has no bearing on how stock, which is statutorily included in the definition of capital, should be treated for capital stock tax purposes.

How Revenue has elected to treat intangible personal property under a different tax has no bearing on how stock should be treated for capital stock tax purposes.

Appellant pays no tax on the stock when the Exemption Theory is utilized.

When the taxpayer pays no tax on the stock, there is no possibility of indirect taxation of stock. (TE, pp. 130-132)

The assessments in dispute relate to whether separate accounts should be included or excluded from capital for purposes of calculating capital stock tax. (Stipulated Joint Appendix, pp. 51, 52, 62, 71, 72)

A life insurance company such as Monumental is required by law to file an "Annual Statement" (sometimes referred to as a "Blue Book") with the Commonwealth of Kentucky Department of Insurance reporting its

general account assets and liabilities, and, if applicable, an "Annual Statement of the Separate Accounts" (sometimes referred to as a "Green Book"). (Stip. 29)

Monumental reported the separate accounts as a single line item on their Blue Books, but failed to list them on line 1 of their capital stock tax returns as capital, as required by KRS 136.320, (TE, pp. 55, 56, 170, 215)

The separate accounts, and accompanying detail, are listed in the Green Books, which are financial statements separate and apart from the Blue Books. (Tr. 153-54, 170)

Monumental is the legal owner of the assets contained in the separate account(s). When there are excess assets generated by income, those assets are transferred out of the separate accounts into the general account. (TE, pp. 157, 161-62)

The Green Books, which detailed the separate accounts, were normally not provided to Revenue when the tax return and Blue Books were filed. (TE, pp. 98, 204-05)

A Green Book was provided to Revenue in connection with the 1998 tax return. (TE, pp. 217-218)

Upon receipt of the 1998 return, Revenue issued an Amended Notice dated May 5, 1999 which

recomputed the 1998 fair cash value of Monumental's "taxable capital." Additional notices were sent for tax years 1995, 1996 and 1997. (Stip. 17, 20)

Appellant timely protested these assessments for 1995-1998. (Stip. 18, 21)

Revenue agreed to waive the penalties associated with the failure to list separate accounts in 1995, 1996, and 1997 for reasonable cause, and indicated that it would have considered waiving the penalties prior to hearing, had it been requested to do so. (TE, pp. 46-50)

The statute at issue, KRS 136.320, imposes a property tax or ad valorem tax.

The Appellant based its refund requests on the Kentucky Supreme Court's decision handed down in *St. Ledger.* KRS 136.320 has constitutional implications.

Monumental has failed to provide proof to establish that the doctrine of contemporaneous construction applies to this appeal.

The separate accounts are "property" as contemplated by the statutes, the legislature and the Kentucky Constitution. As such the assessment as omitted property was proper.

The contract concept of accord and satisfaction is inapplicable in this case and is specifically preempted by the statues allowing reassessment of omitted property.

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The fair cash value of the property contained in the separate accounts is that value stated in the "green book" filed with the Kentucky Department of Insurance.

Monumental failed to preserve the ERISA issue for review. Even if Monumental had preserved this issue for review, ERISA does not preempt KRS 136.320, as there is no showing that KRS 136.320 has any connection or reference to any benefit plan. KRS 136.320 does not burden any ERISA plan that may exist, does not infiltrate the relationship between employees and their employers or their plan. KRS 136.320 is a neutral tax of general application.

CONCLUSIONS OF LAW

The Board of Tax Appeals is vested with exclusive jurisdiction over appeals of final rulings of the Revenue Cabinet. KRS 131.340.

The capital stock tax is imposed pursuant to the Kentucky Revised Statutes (KRS) 139.320. The statute in effect during the periods at issue states as follows:

> 136.320 TAX ON TAXABLE CAPITAL OF DOMESTIC LIFE INSURANCE COMPANIES IN LIEU OF OTHER TAXES; STATE AND LOCAL RATES.
>
> (1) Each life insurance company incorporated under the laws of and doing business in Kentucky shall value as of January 1 and

report to Revenue by April 1 each year, on forms prescribed by Revenue, the following:

(a) The fair cash value of the company's intangible personal property, hereinafter referred to as "capital," consisting of all money in hand, shares of stock, notes, bonds, accounts, and other credits, exclusive of due and deferred premiums, whether secured by mortgage, pleas, or otherwise, or unsecured.

(b) The fair cash value of the company's intangible personal property exempt from taxation by law.

(c) The aggregate amount of the company's reserves, reduced by the amount of due and deferred premiums, maintained in accordance with the applicable provisions of KRS 304.6-040 and 304.6-130 to 180, on all outstanding policies and contracts supplementary thereto.

(d) Other information as may be required by Revenue to accurately determine the fair cash value of each company's "taxable capital" and "taxable reserves."

(2) Based on information supplied by each company and other information that may

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be available, Revenue shall value each company's "taxable capital" and "taxable reserves" as follows:

(a) "Taxable capital" shall be determined by deducting "taxable reserves" from "capital," less exempt intangible personal property.

(b) "Taxable reserves" shall be determined by multiplying the aggregate amount of reserves as computed in subsection (1)(c) of this section by the percentage determined by dividing "capital," less exempt intangible personal property.

(c) An annual tax of seventy cents ($0.70) on each one hundred dollars ($100) of the fair cash value of "taxable capital" and one-tenth of one cent ($.001) on each one hundred dollars ($100) of the fair cash value of "taxable reserves" shall be imposed for state purposes . . .

The term "reserves" refers to those funds that the Kentucky insurance code requires insurance companies to retain as necessary to pay all of its unpaid losses and claims. KRS 304.6-010 *et seq.*

The capital stock tax is an "ad valorem" or "property" tax.

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KRS 136.030, prior to *St. Ledger*, provided that individual stockholders of corporations that paid Kentucky taxes on at least 75% of its total property did not have to list their stock for ad valorem tax purposes.

St. Ledger neither addressed nor overruled the capital stock tax in its decision, but did strike 136.030(1) as unconstitutional.

For issues of statutory construction, "it is logical to consider the consequences of one or another conception." *Atlantic Coast Line R. Co. v. Commonwealth*, Ky., 193 S.W.2d 749 (1946): A statute must not be interpreted so as to bring about an absurd or unreasonable result. *George v. Alcoholic Beverage Control Bd.*, Ky., 421 S.W.2d 569 (1965).

Monumental's Exclusion Theory fails to accurately calculate its capital stock tax liability, as it failed to reduce its Net Reserves to reflect the exclusion of their proportionate share of stock.

A cardinal principal of statutory construction is to save and not destroy, and that a court must accommodate as fully as possible the policies and judgments expressed in the statutory scheme as a whole. *Folks v. Barren Co.*, Ky., 232 S.W.2d 1010 (1950); *Commonwealth v. Meyers*, Ky. App., 8 S.W.3d 58 (1999).

There is no ambiguity to the General Assembly's language including stock in "capital" as that term is used in KRS 136.320(1).

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KRS 136.320 is clear that stock is statutorily defined as "capital", therefore; the doctrine of contemporaneous construction with respect to whether stock should be excluded from capital can not apply.

The Exemption Theory does not impermissibly or indirectly tax the stock in determining capital stock tax liability.

Double taxation occurs if the same property is taxed twice, for the same purpose, by the same taxing authority, during identical taxing periods. *Second St. Properties, Inc. v. Fiscal Court of Jefferson Co.*, Ky., 445 S.W.2d 709 (1969). The Exemption Theory does not result in double taxation of the stock.

The Exemption Theory is required to properly interpret KRS 136.320 for calculating capital stock tax.

KRS 304.15-390(1) does *not require* domestic life insurers to establish separate accounts, and only provides that such insurers *may* set up separate accounts.

KRS 304.15-390(6) provides that "Amounts allocated by domestic life insurers to separate accounts in the exercise of the power granted by this section shall be owned by the insurer and the insurer shall not be or hold itself out to be a trustee in respect to such amounts." Appellant is the owner of the separate accounts.

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The separate accounts shall be included in capital, for purposes of determining capital stock tax liability, as they are intangible personal property subject to taxation under section 172 of the Kentucky Constitution and KRS 136.320.

The Appellant based its refund requests on the Kentucky Supreme Court's decision handed down in *St. Ledger.* (Appellant's Petition of Appeal) KRS 136.320 has constitutional implications. *St. Ledger v. Revenue Cabinet,* Ky., 942 S.W. 2d 893 (1997).

Because KRS 136.320 is a property tax and has constitutional implications as applied before the *St. Ledger* decision, any refunds that might be due the Appellant would fall under KRS 134.590. Neither the Revenue Cabinet nor this Board can ignore the *St. Ledger* opinion. But since no refunds are due to be paid to Monumental, that issue is moot. *Henderson Bridge Co. v. Commonwealth,* Ky., 31 S.W. 486, 491 (1895); *Circle "C" Coal Co., Inc. v. Commonwealth,* Ky. App., 628 S.W.2d 883, 885 (1982); Ky. Const. §§ 170-75; *Gillis v. Yount,* Ky., 748 S.W.2d 357, 358-59 (1988). Additionally, neither Jefferson County nor City of Louisville, Kentucky is required to pay refunds or interest. KRS 134.590.

The doctrine of contemporaneous construction does not apply in any respect to this matter. *Revenue Cabinet, Commonwealth of Kentucky v. Lazarus, Inc. et al.,* Ky., 49 S.W.3d 172 (2001).

Appendix D

The separate accounts are "property" as contemplated by the statutes, the legislature and the Kentucky Constitution. As such the assessment as omitted property was proper. KRS 136.320, KRS 132.360, KRS 132.220. Even if the assessment was not on property, Revenue would still have been able to assess under KRS 413.120. ***Maximum Mach. Co v. City of Shepherdsville***, Ky., 17 S.W.3d 890 (2000).

The contract concept of accord and satisfaction is inapplicable in this case and is specifically preempted by the statues allowing reassessment of omitted property. KRS 136.320; KRS 132.360.

The fair cash value of the property contained in the separate accounts is that value stated in the "green book" filed with the Kentucky Department of Insurance with no consideration to encumbrances. ***Henderson Bridge Co. v. Commonwealth***, Ky., 31 S.W. 486, 491 (1895); KRS 136.320.

The Appellant failed to raise the issue of ERISA in its Petition of Appeal, or in any other pleading except its brief, including the pre-hearing compliance statement and the supplemental pre-hearing compliance statement. Therefore it failed to preserve this issue for review by this Board. The Board will not consider the ERISA issue. ***Stoner Creek Stud v. Revenue Cabinet***, Ky. App., 746 S.W. 2d 73 (1987). If the issue had been preserved, the Board believes ERISA does not preempt KRS 136.320, because KRS 136.320 has not been shown to have any connection or reference to any benefit plan.

KRS 136.320 does not burden any ERISA plan that may exist, does not infiltrate the relationship between employees and their employers or their plan. KRS 136.320 is a neutral tax of general application. *Miller v. PPG Industries, Inc.*, 237 F.Supp.2d 756 (W.D. Ky., 2002).

ORDER

The Board orders Revenue's final ruling in this appeal is affirmed. Interest shall apply, but penalties have been waived.

This is a final and appealable order which may be appealed to the Franklin Circuit Court or the Circuit Court of the county in which the aggrieved party resides or conducts his place of business by filing a petition of appeal in the appropriate Circuit Court within thirty (30) days after this final order is mailed or delivered by personal service, pursuant to KRS 13B.140(1) and KRS 131.370(1). Copies of the petition of appeal shall be served by the Petitioner upon the Kentucky Board of Tax Appeals and all parties of record. The petition of appeal shall include the names and addresses of all parties to the proceedings and the Kentucky Board of Tax Appeals, and a statement of the grounds on which the review is requested. The petition of appeal shall be accompanied by a copy of this final order. Within twenty (20) days after service of the petition of appeal, or within further time allowed by the Circuit Court, the Kentucky Board of Tax Appeals shall transmit to the reviewing court the original or a certified copy of the official record of the proceeding under review in compliance with KRS 13B.140(3).

Appendix D

DATE OF ORDER:
DECEMBER 4, 2003

FULL BOARD CONCURRING.

s/ George H. Helton
GEORGE H. HELTON
CHAIRMAN

APPENDIX E — ORDER OF THE COMMONWEALTH OF KENTUCKY, COURT OF APPEALS DENYING PETITION FOR REHEARING DATED SEPTEMBER 8, 2008

COMMONWEALTH OF KENTUCKY
COURT OF APPEALS

NO. 2005-CA-002148-MR

MONUMENTAL LIFE INSURANCE COMPANY, SUCCESSOR IN INTEREST TO COMMONWEALTH LIFE INSURANCE COMPANY

APPELLANT

v.

THE DEPARTMENT OF REVENUE, FORMERLY KNOWN AS THE REVENUE CABINET; ET AL.

APPELLEES

APPEAL FROM FRANKLIN CIRCUIT COURT
ACTION NO. 03-CI-01652

ORDER

1) DENYING PROCEDURAL MOTIONS

2) DENYING PETITION FOR REHEARING

Appendix E

BEFORE: THOMPSON, JUDGE; BUCKINGHAM AND HENRY, SENIOR JUDGES.[1]

This Court has considered appellant's motion to correct the record and appellant's motion for leave to file a reply to the response to the motion. The Department of Revenue has filed responses in opposition to the motions.

Having considered the motions, the Court ORDERS the motions be, and they are hereby, DENIED.

Having considered the petition for rehearing and the response thereto, the Court ORDERS the petition be, and it is hereby, DENIED.

HENRY, SENIOR JUDGE, CONCURS.

THOMPSON, JUDGE DISSENTS TO THE EXTENT THAT HE WOULD GRANT THE MOTIONS BUT CONCURS WITH THE DENIAL OF THE PETITION.

ENTERED: 09/08/08

s/ David C. Buckingham
SENIOR JUDGE, COURT OF APPEALS

---

1. Senior Judges David C. Buckingham and Michael Henry sitting as Special Judges by assignment of the Chief Justice pursuant to Section 110(5)(b) of the Kentucky Constitution and KRS 21.580.

APPENDIX F — ORDER DENYING DISCRETIONARY REVIEW OF THE SUPREME COURT OF KENTUCKY DATED OCTOBER 21, 2009

SUPREME COURT OF KENTUCKY

2008-SC-000739-D
(2005-CA-002148-MR)

FRANKLIN CIRCUIT COURT
CASE NO. 03-CI-01652

MONUMENTAL LIFE INSURANCE COMPANY, SUCCESSOR IN INTEREST TO COMMONWEALTH LIFE INSURANCE COMPANY

MOVANT

V.

THE DEPARTMENT OF REVENUE, FINANCE AND ADMINISTRATION CABINET, COMMONWEALTH OF KENTUCKY; LOUISVILLE/JEFFERSON COUNTY METRO GOVERNMENT, FKA CITY OF LOUISVILLE, KENTUCKY, AND JEFFERSON COUNTY; KENTUCKY; AND KENTUCKY BOARD OF TAX APPEALS

RESPONDENTS

Appendix F

ORDER DENYING DISCRETIONARY REVIEW

The motion for review of the decision of the Court of Appeals is denied.

Scott, J., would grant review.

Abramson, J., not sitting.

ENTERED: October 21, 2009.

s/ [illegible]
CHIEF JUSTICE

APPENDIX G — RELEVANT STATUTES

29 U.S.C.A. § 1144

§ 1144. Other laws

Except as provided in subsection (b) of this section, the provisions of this subchapter and subchapter III of this chapter shall supersede any and all State laws insofar as they may now or hereafter relate to any employee benefit plan described in section 1003(a) of this title and not exempt under section 1003(b) of this title. This section shall take effect on January 1, 1975.

(1) This section shall not apply with respect to any cause of action which arose, or any act or omission which occurred, before January 1, 1975.

(2)(A) Except as provided in subparagraph (B), nothing in this subchapter shall be construed to exempt or relieve any person from any law of any State which regulates insurance, banking, or securities.

(B) Neither an employee benefit plan described in section 1003(a) of this title, which is not exempt under section 1003(b) of this title (other than a plan established primarily for the purpose of providing death benefits), nor any trust established under such a plan, shall be deemed to be an insurance company or other insurer, bank, trust company, or investment company or to be engaged in the business of insurance or banking for purposes of any law of any State purporting to regulate insurance companies, insurance contracts, banks, trust companies, or investment companies.

(3) Nothing in this section shall be construed to prohibit use by the Secretary of services or facilities of a State agency as permitted under section 1136 of this title.

(4) Subsection (a) of this section shall not apply to any generally applicable criminal law of a State.

(5)(A) Except as provided in subparagraph (B), subsection (a) of this section shall not apply to the Hawaii Prepaid Health Care Act (Haw.Rev.Stat. §§ 393-1 through 393-51).

(B) Nothing in subparagraph (A) shall be construed to exempt from subsection (a) of this section—

(i) any State tax law relating to employee benefit plans, or

(ii) any amendment of the Hawaii Prepaid Health Care Act enacted after September 2, 1974, to the extent it provides for more than the effective administration of such Act as in effect on such date.

(C) Notwithstanding subparagraph (A), parts 1 and 4 of this subtitle, and the preceding sections of this part to the extent they govern matters which are governed by the provisions of such parts 1 and 4, shall supersede the Hawaii Prepaid Health Care Act (as in effect on or after January 14, 1983), but the Secretary may enter into cooperative arrangements under this paragraph and section 1136 of this title with officials of the State of Hawaii to assist them in effectuating the policies of provisions of such Act which are superseded by such parts 1 and 4 and the preceding sections of this part.

Appendix G

(6)(A) Notwithstanding any other provision of this section—

(i) in the case of an employee welfare benefit plan which is a multiple employer welfare arrangement and is fully insured (or which is a multiple employer welfare arrangement subject to an exemption under subparagraph (B)), any law of any State which regulates insurance may apply to such arrangement to the extent that such law provides—

(I) standards, requiring the maintenance of specified levels of reserves and specified levels of contributions, which any such plan, or any trust established under such a plan, must meet in order to be considered under such law able to pay benefits in full when due, and

(II) provisions to enforce such standards, and

(ii) in the case of any other employee welfare benefit plan which is a multiple employer welfare arrangement, in addition to this subchapter, any law of any State which regulates insurance may apply to the extent not inconsistent with the preceding sections of this subchapter.

(B) The Secretary may, under regulations which may be prescribed by the Secretary, exempt from subparagraph (A)(ii), individually or by class, multiple employer welfare arrangements which are not fully insured. Any such exemption may be granted with respect to any arrangement or class of arrangements

only if such arrangement or each arrangement which is a member of such class meets the requirements of section 1002(1) and section 1003 of this title necessary to be considered an employee welfare benefit plan to which this subchapter applies.

(C) Nothing in subparagraph (A) shall affect the manner or extent to which the provisions of this subchapter apply to an employee welfare benefit plan which is not a multiple employer welfare arrangement and which is a plan, fund, or program participating in, subscribing to, or otherwise using a multiple employer welfare arrangement to fund or administer benefits to such plan's participants and beneficiaries.

(D) For purposes of this paragraph, a multiple employer welfare arrangement shall be considered fully insured only if the terms of the arrangement provide for benefits the amount of all of which the Secretary determines are guaranteed under a contract, or policy of insurance, issued by an insurance company, insurance service, or insurance organization, qualified to conduct business in a State.

(7) Subsection (a) shall not apply to qualified domestic relations orders (within the meaning of section 1056(d)(3)(B)(i) of this title).

(8) Subsection (a) of this section shall not apply to any State law mandating that an employee benefit plan not include any provision which has the effect of limiting or excluding coverage or payment for any health care for

an individual who would otherwise be covered or entitled to benefits or services under the terms of the employee benefit plan, because that individual is provided, or is eligible for, benefits or services pursuant to a plan under title XIX of the Social Security Act [42 U.S.C.A. § 1396 et seq.], to the extent such law is necessary for the State to be eligible to receive reimbursement under title XIX of that Act.

For purposes of this section:

(1) The term "State law" includes all laws, decisions, rules, regulations, or other State action having the effect of law, of any State. A law of the United States applicable only to the District of Columbia shall be treated as a State law rather than a law of the United States.

(2) The term "State" includes a State, any political subdivisions thereof, or any agency or instrumentality of either, which purports to regulate, directly or indirectly, the terms and conditions of employee benefit plans covered by this subchapter.

Nothing in this subchapter shall be construed to alter, amend, modify, invalidate, impair, or supersede any law of the United States (except as provided in sections 1031 and 1137(b) of this title) or any rule or regulation issued under any such law.

Appendix G

KRS 136.320

136.320. Tax on property of domestic life insurance companies in lieu of other taxes — State and local rates. (1) Each life insurance company incorporated under the laws of and doing business in Kentucky shall value as of January 1 and report to the department of revenue by July 15, 1966, and by April 1 each year thereafter, on forms prescribed by the department of revenue, the following:

(a) The fair cash value of the company's intangible personal property, hereinafter referred to as "capital," consisting of all money in hand, shares of stock, notes, bonds, accounts and other credits, exclusive of due and deferred premiums, whether secured by mortgage, pledge or otherwise, or unsecured.

(b) The fair cash value of the company's intangible personal property exempt from taxation by law.

(c) The aggregate amount of company's reserves, reduced by the amount of due and deferred premiums, maintained in accordance with the applicable provisions of KRS 304.6-040 and 304.6-130 to 304.6-180, on all outstanding policies and contracts supplementary thereto.

(d) Such other information as may be required by the department of revenue to accurately determine the fair cash value of each company's "taxable capital" and "taxable reserves."

(2) Based on information supplied by each company and such other information as may be available, the department of revenue shall value each company's "taxable capital" and "taxable reserves" as follows:

(a) "Taxable capital" shall be determined by deducting "taxable reserves" from "capital," less exempt intangible personal property.

(b) "Taxable reserves" shall be determined by multiplying the aggregate amount of reserves as computed in subsection (1) (c) of this section by the percentage determined by dividing "capital," less exempt intangible personal property, by "capital," including exempt intangible personal property,

(3) An annual tax of seventy cents (70¢) on each one hundred dollars ($100) of the fair cash value of "taxable capital" and one-tenth of one cent ($.001) on each one hundred dollars ($100) of the fair cash value of "taxable reserves" shall be imposed for state purposes. The tax shall be in lieu of all excise, license, occupational, or other taxes imposed by the state, county, city, or other taxing district; except as provided in subsections (4), (5), and (6) of this section.

(4) The county in which the principal office of the company is located may impose a tax of fifteen cents (15¢) on each one hundred dollars ($100) of "taxable capital."

(5) The city in which the principal office of the company is located may impose a tax of fifteen cents (15¢) on each one hundred dollars ($100) of "taxable capital."

(6) The department of revenue shall by September 1 each year bill each company for the state taxes. It shall immediately certify to the county clerk of the county in which the principal office of the company is located the value of "taxable capital" subject to local taxation. The county clerk shall prepare and deliver a bill to the sheriff for collection of taxes collectible by the sheriff and shall certify the value to all other collecting officers of districts authorized to levy a tax.

(7) Each company's real and tangible personal property shall be subject to taxation at fair cash value by the state, county, school, and other taxing districts in which such property is located in the same manner and at the same rates as all other property of the same class.

(8) Taxes on property subject to taxation under this section shall be subject to the same discount and penalties as provided in KRS 134.020 and shall be collected in the same manner as taxes on property locally assessed, except that the state tax on the "taxable capital" and "taxable reserves" shall be collected directly by the department of revenue.

(9) Any taxpayer subject to taxation under this section may protest in the manner provided in KRS 131.110. (4237a-1: amend. Acts 1966, ch. 160, §§ 1, 2; 1972, ch. 203, § 8; 1976, ch. 93, § 11, effective January 1, 1977; 1978, ch. 384, § 282, effective June 17, 1978.)

Appendix G

Ky. Rev. Stat. § 304.15-390(1)

Pension, retirement, profit-sharing, life insurance or annuity agreements; separate accounts

(1) A domestic life insurer may establish one (1) or more separate accounts, and may allocate thereto, in accordance with the terms of a written contract or agreement, any amounts paid to the insurer in connection with a pension, retirement or profit-sharing plan, life insurance, or an annuity which are to be applied to provide benefits payable in fixed or in variable dollar amounts or in both.

Appendix G

Ky. Rev. Stat. § 132.043

RETIREMENT PLAN, INTEREST TAXABLE BY STATE; RATE; COLLECTION; NOT SUBJECT TO LOCAL TAXES

(1) To the extent that any right or interest, vested or otherwise, in a plan established by or for an individual or individuals for retirement purposes and meeting the requirements for exemption under the federal income tax laws may be held to be subject to assessment and taxation, the basis of the assessment shall be the fair cash value of such vested right or interest.

(2) The owner or person enjoying such right or interest, on January 1 of each year, shall pay a tax to the state of one-tenth of one cent ($0.001) upon each one hundred dollars ($100) of the fair cash value. No other tax shall be assessed by the state or by any county, city, school district, or other taxing district on any such right or interest or against the holder of any such right or interest.

(3) The administrator, executor, trustee, guardian, conservator, curator, or agent of any plan established for retirement purposes, as defined in subsection (1) of this section may list and pay the applicable tax for all of the participants in the plan subject to taxation by virtue of their respective vested rights or interests in such pension plan, and the owner or person enjoying such right or interest shall be deemed to have paid such tax.

APPENDIX H — EXCERPTED TAX FACTS

TAX FACTS

A Digest of Kentucky Tax Laws

Commonwealth of Kentucky

REVENUE CABINET

1994

Greenbaum Doll & McDonald, PLLC
Library
3500 National City Tower
101 S. Fifth St.
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Appendix H

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* * *

FOREWORD

The Revenue Cabinet presents the 1994 edition of ***Tax Facts***, a booklet summarizing Kentucky tax statutes and providing other relevant information.

This publication is printed biannually to reflect changes made by each session of the Kentucky General Assembly and to explain the essential facts about the current revenue system. The ***1994 Tax Facts*** contains information about the changes in the tax laws enacted during the 1993 Second Extraordinary Session of the General Assembly and the 1994 Regular Session of the General Assembly.

We hope this issue of ***Tax Facts*** is helpful to tax practitioners and to the general public. Suggestions for improvements to the publication are always welcome.

s/ Kim Burse
Kim Burse
Secretary of Revenue
December 30, 1994

Appendix H

The changes enacted by the 1995 Second Extraordinary Session of the General Assembly are reflected in this edition of Tax Facts.

* * *

RETIREMENT OR PROFIT-SHARING PLAN TAX

(KRS 132.043)

KRS 132.043 requires that administrators, executors, trustees, etc., of any plan established for retirement purposes list the plan and pay the intangible property tax of one-tenth of 1 cent per $100 of taxable funds on behalf of plan participants.

However, Section 514 of ERISA pre-empts or nullifies KRS 132.043 as it was being administered. Therefore, the Revenue Cabinet is not currently enforcing the statute.

Individual plan participants should report their interest in plans on Form 62A376, Intangible Property Tax Return, Section 9.

* * * *

(2)

No. 09-865

Supreme Court, U.S.
FILED
FEB 22 2010
OFFICE OF THE CLERK

In The
Supreme Court of the United States

MONUMENTAL LIFE INSURANCE COMPANY
(SUCCESSOR IN INTEREST TO
COMMONWEALTH LIFE INSURANCE COMPANY),

Petitioner,

v.

DEPARTMENT OF REVENUE, FINANCE AND ADMINISTRATION CABINET, COMMONWEALTH OF KENTUCKY (f/k/a Revenue Cabinet); LOUISVILLE/JEFFERSON COUNTY METRO GOVERNMENT (f/k/a Jefferson County, Kentucky and the City of Louisville, Kentucky); and KENTUCKY BOARD OF TAX APPEALS,

Respondents.

On Petition For A Writ Of Certiorari To The Kentucky Court Of Appeals

BRIEF IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether petitioner has properly preserved the issue of whether Section 514 of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), 29 U.S.C. § 1144, "bars" the tax imposed by KRS 136.320, when the Kentucky Court of Appeals, Franklin Circuit Court and Kentucky Board of Tax Appeals ("KBTA") have all held that this issue has not been preserved for review?

2. If the answer to the first question is yes, whether ERISA "bars" the tax imposed by KRS 136.320, when the KBTA, as the finder of fact, held that even if the ERISA issue had been preserved, the petitioner made no showing that KRS 136.320 has any connection or reference to any benefit plan?

3. Whether the Kentucky Court of Appeals' decision that treating shares of stock ("Stock") as exempt intangible property with respect to the calculation of capital stock tax pursuant to KRS 136.320, when the exemption results in none of the tax liability being attributable, either directly or indirectly, to Stock, conflicts with *St. Ledger v. Kentucky Revenue Cabinet,* 517 U.S. 1206, 116 S.Ct. 1821, 134 L.Ed.2d 927 (1996), and *Fulton Corp. v. Faulkner,* 516 U.S. 325, 116 S.Ct. 848, 133 L.Ed.2d 796 (1996), which held that remedies are an issue of state law, and other opinions of this Court, including *American Bank and Trust Co. v. Dallas County*, 463 U.S. 855, 103 S.Ct. 3369, 77 L.Ed.2d 1072 (1983), which addressed indirect taxation?

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OTHER AUTHORITIES

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BRIEF IN OPPOSITION TO WRIT FOR CERTIORARI

COUNTERSTATEMENT OF THE CASE

Revenue (also "Department" or "Department of Revenue") disagrees with the Petitioner's Statement of the Case as well as with the Petitioner's representation of the questions presented for review. First, pursuant to Supreme Court Rule 14.1(g)(i), if review of a state-court judgment is sought, as in this case, the Petitioner is required to indicate in its Petition:

> specification of the stage in the proceedings, both ***in the court of first instance*** and in ***the appellate courts***, when the federal questions sought to be reviewed were raised; the method or manner of raising them and the way in which they were passed on by those courts; and the pertinent quotations of specific portions of the record or summary thereof, with specific reference to the places in the record where the matter appears . . . , so as to show that the federal question was timely and properly raised and that this Court has jurisdiction to review the judgment on a writ of certiorari.

(Emphasis added.) *See also* Supreme Court Rule 24(1)(e); 28 U.S.C. § 1257(a).

Although Petitioner attempts compliance with this rule in its petition under the heading "Statement of the Case" (subheadings E and F), a simple review of the initiating documents involved in this matter and the record as a whole, clearly indicates that the

Kentucky Board of Tax Appeals (KBTA), the Franklin Circuit Court, and the Kentucky Court of Appeals were entirely correct when they determined that the Petitioner had failed to preserve any federal issue. This Court therefore lacks jurisdiction in this case since the question of whether or not the Petitioner failed to preserve an issue for review is a matter of state law rather than federal law, and the "unambiguous application of state procedural law makes it unnecessary for [this Court] to review the asserted claim." *Jimmy Swaggart Ministries v. Board of Equalization of California,* 493 U.S. 378, 110 S.Ct. 688, 107 L.Ed.2d 796 (1990), *citing Michigan v. Long*, 463 U.S. 1032, 1041-1042, 103 S.Ct. 3469, 3476-3477, 77 L.Ed.2d 1201 (1983).

Second, the Petitioner's recitation of the historical background of this case implores clarification. The Petitioner filed refund claims with the Department for the tax years 1990 through 1996, based on a lawsuit brought by other taxpayers challenging the constitutionality of certain statutes.[1] These were "protective refund claims" filed for the purpose of tolling the statute of limitations on refunds of state taxes. The reasoning was that if the taxpayers in the

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[1] *St. Ledger v. Revenue Cabinet*, 912 S.W.2d 34 (Ky. 1995), *cert. granted, judgment vacated by remand, St. Ledger v. Kentucky Revenue Cabinet*, 517 U.S. 1206, 116 S.Ct. 1821, 134 L.Ed.2d 927 (1996), *on remand, St. Ledger v. Revenue Cabinet*, 942 S.W. 2d 893 (Ky. 1997), *cert. dismissed, St. Ledger v. Kentucky Revenue Cabinet*, 521 U.S. 1146, 118 S.Ct. 27, 138 L.Ed.2d 1057 (1997).

St. Ledger case were successful in their challenge, the Petitioner would also be due tax refunds.

The statutes at issue in *St. Ledger* were Kentucky Revised Statutes (KRS) 132.020, which imposed the tax on specific property, including shares of stock; KRS 132.030, which lowered the tax rate on Kentucky, but not on out-of-state, bank deposits;[2] and KRS 136.030, which exempted individual stockholders of corporations who paid Kentucky tax on at least 75% of its total property from listing their stock for ad valorem tax purposes (the "Exemption Statute"). The Kentucky Supreme Court held that the Exemption Statute and the corporate shares tax portion of KRS 132.020 (the "Corporate Shares Tax") were unconstitutional, striking down both provisions. *St. Ledger*, 942 S.W.2d at 898.

But the Petitioner was taxed under KRS 136.320 – the Capital Stock Tax – not under KRS 132.020:[3] The Capital Stock Tax was a property tax based on the value of "capital," including Stock. Importantly, KRS 136.320 was not struck down by *St. Ledger*.

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[2] The bank deposits tax, KRS 132.030, is not an issue in this matter.

[3] " . . . and forty-five cents ($0.45) upon each one hundred dollars ($100) of value of all other property directed to be assessed for taxation shall be paid by the owner or person assessed except as provided in subsection (2) of this section **and KRS . . . 136.320, and other sections providing a different tax rate for particular property.**" *See* KRS 132.020(1), eff. July 13, 1990. (Emphasis supplied.)

However, since certain stocks taxed under the Corporate Shares Tax were exempted from intangible property tax, Revenue likewise treated the Petitioner's Stock as *exempt* intangible personal property for Capital Stock Tax purposes (the "Exemption Method").

The Petitioner was refunded $1,470,357.49 in Capital Stock Tax based on KRS 136.320, as applied in light of *St. Ledger*.[4] However, the Petitioner then claimed another $6,751,758.46 in refunds based upon its position that Stock must be *excluded* from the statutory taxing formula entirely, rather than exempted, when calculating Capital Stock Tax (Monumental's Exclusion Theory or "MET").

Revenue used information supplied by the Petitioner itself to calculate its Capital Stock Tax liability, as the tax was self-reporting.[5] The Kentucky Department of Insurance requires that insurance companies file a "Blue Book" with it each year. The "Blue Book" reports all of an insurance company's (including the Petitioner's) assets, except those found in any Separate Account. The Department of Revenue also required that the "Blue Book" be provided to it in order to verify the Petitioner's Capital Stock Tax returns. Importantly, Revenue did not know if the

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[4] KRS 136.320 was amended by act of the 1998 legislature, but this amendment does not affect this case.

[5] The Petitioner is no longer located in Kentucky and no longer files tax returns with Revenue.

Petitioner had Separate Accounts or not, unless it reported the value of those accounts to the Department on its property tax returns. Monumental Life Insurance never reported its Separate Accounts to Revenue and never included them on its tax returns.

Monumental employee Colleen Lyons testified that ***she usually*** filed the Petitioner's Capital Stock Tax returns with Revenue each year. (Record, Box 5, Vol. 30, Tab 151. This is the "Transcript of Evidence," hereinafter "TE," pp. 33-40.) Ms. Lyons testified that ***she always*** supplied Revenue the "Blue Book" with the returns, ***but never*** supplied Revenue a "Green Book" which set forth the assets held in Separate Accounts. (TE, pp. 97-99.) ("Green Book" found at Record, Box 4, Vol. 27, Tab 30.) In 1998, however, Ms. Lyons testified that ***she did not*** prepare or file the tax returns with Revenue. (TE, p. 51, 99, 215.) But in that same year, Revenue employee Edna Driskell did receive a "Green Book" for the first time ever from the Petitioner and questioned the Petitioner's failure to list its Separate Accounts on its property tax returns. (Record, Box 1, Vol. 3, Tab 49, pp. 51, 52.) An assessment was then made based upon the omitted property contained in the Separate Accounts for the years 1995 through 1998. (Record, Box 1, Vol. 5, Tab 67, pp. 90-93.)

This testimony is relevant to the Petitioner's continued and unfounded assertions that Revenue billed the Petitioner in response to its request for refunds, and that the Petitioner had never been taxed on its Separate Accounts before. Despite the single

dissenting opinion at the Kentucky Court of Appeals to the contrary, every witness deposed by the Petitioner disproved such a theory. It is more likely that the "Green Book" was sent to Revenue by mistake by an employee acting in Ms. Lyon's stead, which began the assessment inquiry. And the only reason that the Petitioner had not been taxed on its Separate Accounts previously is because it had never, in its entire history with the Commonwealth of Kentucky, provided the Department of Revenue with information showing it owned property in Separate Accounts. So while the Petitioner states that assets of this nature have not been subject to this tax "for decades," the truth is that the assets were always subject to the tax but the Petitioner did not report the assets as required by law. (*See* petition for writ, p. *i*.)

This matter was heard by the Kentucky Board of Tax Appeals ("KBTA") on July 16, 2002. The KBTA upheld Revenue's Final Ruling Letter in its December 4, 2003 Order. The Franklin Circuit Court's Opinion affirmed the KBTA on September 22, 2005. The Kentucky Court of Appeals issued its Opinion Affirming the Franklin Circuit Court on June 27, 2008. The Kentucky Supreme Court denied Discretionary Review on October 21, 2009. The Petition to this Court for a Writ of Certiorari to the Kentucky Court of Appeals followed.

REASONS FOR DENYING THE WRIT

A. THE PETITIONER HAS FAILED TO PRESERVE THE ERISA ISSUE FOR REVIEW BY THIS COURT.

In a transparent attempt to manufacture a circuit conflict warranting this Court's attention, Petitioner ignores the only real question presented: whether or not the Petitioner preserved the ERISA[6] issue for review. This is a question of state law, rather than federal law. *Jimmy Swaggart Ministries v. Board of Equalization of California,* 493 U.S. at 397.

This Court has clearly stated that "[w]ith 'very rare exceptions,' we will not consider a petitioner's federal claim unless it was either addressed by or properly presented to the state court that rendered the decision we have been asked to review." *Campbell v. Louisiana*, 523 U.S. 392, 118 S.Ct. 1419, 140 L.Ed.2d 551 (1998), *citing Adams v. Robertson*, 520 U.S. 83, 86, 117 S.Ct. 1028, 1029, 137 L.Ed.2d 203 (1997).

The Kentucky Court of Appeals, in support of its finding that it would not consider the issue of ERISA, cited the KBTA's Order that "[Monumental] failed to raise the issue of ERISA in its Petition of Appeal, or in any other pleading except its brief, including the pre-hearing compliance statement and the

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[6] Employee Retirement Income Security Act of 1974, 29 U.S.C. § 1001, et seq.

supplemental pre-hearing compliance statement." But the Court also concluded that "Monumental does not cite us to its preservation of this issue as required by CR 76.12(4)(c).[7] *Shelton v. Commonwealth,* 992 S.W.2d 849, 852 (Ky. App. 1998)." *Monumental Life Ins. Co. v. Department of Revenue*, 294 S.W.3d 10, 22 (2008). Hence, the Petitioner has failed to preserve the federal ERISA issue at *both* the court of first instance – the KBTA, *and* at the Kentucky Court of Appeals. The Petitioner has therefore failed to preserve the ERISA question for review not once, but twice and in two separate forums.

Further, the Petitioner's argument to the contrary, it is the KBTA – not the Franklin Circuit Court that was, and is, the court of first instance and the finder of fact in this case. While the Petitioner argues that the appeal to the Franklin Circuit Court was an *original* action, and that the federal issue was preserved at that level, the United States Supreme Court, the Kentucky Court of Appeals, the law in Kentucky and common sense disagree. (*See* petition for writ, p. 18.)

Pursuant to KRS 131.110, a taxpayer is required to protest any assessment or denial of a refund request directly to the Department of Revenue. The

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[7] The Kentucky Rules of Civil Procedure 76.12(4)(c)(v) requires that the Petitioner's Court of Appeals brief " . . . . shall contain at the beginning of the argument a statement with reference to the record showing whether the issue was properly preserved for review and, if so, in what manner."

protest must be in writing and accompanied by a supporting statement "*setting forth the grounds upon which the protest is made.*" KRS 131.110(1). After consideration of the written protest and the supporting statement, the Department is required to issue a final ruling to the taxpayer. In this case, the Petitioner's protest and its supporting statement never mentioned any federal ERISA issue, and no argument was ever presented that the ERISA issue should be considered by the Department.

If the taxpayer disagrees with the Department's final ruling, it may file a petition of appeal with the KBTA pursuant to the terms of KRS 131.340. KRS 131.110(5). KRS 131.340(1) states that "[t]he Kentucky Board of Tax Appeals is hereby vested with exclusive jurisdiction to hear and determine appeals from final rulings. . . ." It further states that hearings before the KBTA "shall be de novo and conducted in accordance with KRS Chapter 13B." In turn, Chapter 13B sets forth the KBTA's authority to issue administrative regulations governing the conduct of hearings. "An agency shall have authority to promulgate administrative regulations that are necessary to carry out the provisions of this chapter." KRS 13B.170(1). The KBTA's administrative regulations specifically require the petition of appeal to "**contain a statement of all relevant issues of fact and law.**" 802 KAR 1:010(2)(e). (Emphasis added.) In this case, the Petitioner's petition of appeal to the KBTA, although well over 60 pages in length and containing a multitude of issues and arguments, never once

mentioned an ERISA issue. Likewise, pursuant to the KBTA's Order and its administrative regulations, the parties are required to file pre-hearing statements with the Board. The Order and the administrative regulations required the parties to plead "the party's position on any issue of fact in dispute" and "the party's position of any issue of law raised by the appeal." 802 KAR 1:010(6)(a) and (b). The Petitioner did file its prehearing statement as well as a supplemental prehearing statement, but nowhere did the Petitioner raise a federal ERISA issue. Indeed the first mention of the ERISA issue, over objection, was presented at the KBTA hearing.

From the KBTA, an appeal can be taken by an aggrieved party to the Circuit Court. KRS 131.370. This appeal must comply with "KRS 13B." KRS 131.370(1). In turn, KRS Chapter 13B sets forth the legal perimeters within which the Circuit Court can consider the appeal. That statute states as follows:

> **13B.150 Conduct of judicial review.**
>
> (1) Review of a final order shall be conducted by the court without a jury and **shall be confined to the record**, unless there is fraud or misconduct involving a party engaged in administration of this chapter. The court, upon request, may hear oral argument and receive written briefs.
>
> (2) **The court shall not substitute its judgment for that of the agency as to the weight of the evidence on questions of fact.** The court may affirm the final order

> or it may reverse the final order, in whole or in part, and remand the case for further proceedings if it finds the agency's final order is:
>
> (a) In violation of constitutional or statutory provisions;
>
> (b) In excess of the statutory authority of the agency;
>
> (c) Without support of substantial evidence on the whole record;
>
> (d) Arbitrary, capricious, or characterized by abuse of discretion;
>
> (e) Based on an ex parte communication which substantially prejudiced the rights of any party and likely affected the outcome of the hearing;
>
> (f) Prejudiced by a failure of the person conducting a proceeding to be disqualified pursuant to KRS 13B.040(2) or;
>
> (g) Deficient as otherwise provided by law.

(Emphasis added.)

This statute and the other laws and administrative regulations governing the appeal of tax cases defines the role of the Circuit Court as being one of a reviewing and appellate Court, rather than an initial trier of fact. The law ensures that the aggrieved party has a right of appeal to both the Circuit Court and the Kentucky Court of Appeals by making the initial appeal to the Circuit Court an original action. The

law does not confer upon the aggrieved party the right to raise new issues and arguments at the Circuit Court level. Hence, this case is directly on point with this Court's decision rendered in *Jimmy Swaggart Ministries v. Board of Equalization of California,* 493 U.S. at 397, 398, in which this Court stated:

> We decline to reach the merits of this claim, however, because the courts below ruled that the claim was procedurally barred.
>
> Thus, under state law, "[t]he claim for refund delineates and restricts the issues to be considered in a taxpayer's refund action. The trial court and [appellate] court are without jurisdiction to consider grounds not set forth in the claim." *Atari, Inc. v. State Board of Equalization,* 170 Cal.App.3d 665, 672, 216 Cal.Rptr. 267, 271 (1985) (citations omitted). This rule serves a legitimate state interest in requiring parties to exhaust administrative remedies before proceeding to court, for "[s]uch a rule prevents having an overworked court consider issues and remedies available through administrative channels." *Id.,* at 673, 216 Cal.Rptr., at 272.
>
> The record in this case makes clear that appellant, in its refund claim before the Board, failed even to cite the Commerce Clause or the Due Process Clause, much less articulate legal arguments contesting the nexus issue.

In another case considered by this Court, the Petitioner sought to raise a res judicata defense. This Court declined to address that issue, holding that the Illinois Appellate Court's ruling that the Petitioner neither formally pled nor attempted to prove its claim at the circuit court level " . . . constitutes an adequate state ground that forecloses any jurisdiction that we might possess to review the merits of the res judicata defense." *Cousins v. Wigoda*, 419 U.S. 477, 955 S.Ct. 541, 42 L.Ed.2d 595 (1975), *citing Louisville & N.R. Co. v. Woodford*, 234 U.S. 46, 345 S.Ct. 739, 58 L.Ed. 1202 (1914).

Such is the situation here. Petitioner's failure to preserve the ERISA issue constitutes an adequate state ground warranting denial of the petition. Kentucky law is very clear that a litigant must raise an issue before the administrative tribunal. *Urella v. Kentucky Bd. of Med. Licensure*, 939 S.W.2d 896 (Ky. 1997). In *Urella*, the Kentucky Supreme Court agreed with the administrative agency's decision that the Petitioner's argument was not preserved for review, stating:

> . . . having reviewed the record, we agree with the Board that this argument is not preserved for review. It was not presented to the ALJ, nor to the Board until 10 days after oral arguments. Neither was the issue addressed by the trial court or Court of Appeals. It is well established that failure to raise an issue before an administrative body precludes the assertion of that issue in an action for judicial review, or as an initial matter on discretionary review to this court.

> *Jackson v. State Auto. Mutual Insurance Company*, Ky., 837 S.W.2d 496, 498 (1992); *Personnel Board v. Heck*, Ky.App., 725 S.W.2d 13, 17 (1987).

Id. at 873. *See also*, *Stoner Creek Stud v. Revenue Cabinet*, 746 S.W.2d 73 (Ky. App. 1987); (Emphasis supplied.)

In the this case, the Court of Appeals upheld the KBTA's decision not to review issues which were not raised in the initial protest and supporting statements to the Department of Revenue, the Petition of Appeal to the KBTA, the prehearing compliance statement or the supplemental prehearing compliance statement. *Stoner Creek Stud*, 746 S.W.2d 73. The administrative tribunal and state courts properly applied state law to hold that procedurally, Petitioner failed to preserve the ERISA issue for review. While Petitioner disagrees with this conclusion, ultimately, the issue of whether the ERISA issue was preserved for review is purely a state procedural issue, and there simply is no federal issue for this Court to consider.

The Kentucky Court of Appeals' Opinion, from which the petition herein is taken, declined to address the ERISA issue at all. Even so, the Petitioner continues to concentrate on the substantive merits of the ERISA issue, while mendaciously glossing over its neglect in raising the ERISA question prior to the hearing. Its argument of course, begs response.

Says the Petitioner:

> [i]n its Petition of Appeal to the Board, Monumental *raised the Separate Accounts issue* and, *through discovery* and at the *hearing, introduced evidence supporting* its argument that ERISA preempted Kentucky's taxation of Separate Account assets.

(*See* petition for writ, p. 16; emphasis added.)

As with the lower Courts, the Petitioner uses this distortion of the facts in a thinly veiled attempt to convince this Court that the federal ERISA issue was actually raised before the Department of Revenue and the KBTA. Such was not the case.

The truth of the matter is simply this: the Petitioner's petition of appeal to the KBTA ***did not include ERISA in its*** "**statement of all relevant issues of fact and law**." 802 KAR 1:010(2)(e). (Emphasis added.) Importantly, the Petitioner has not and cannot counter this fact. Nor did the Petitioner plead ERISA in its "**position on any issue of fact in dispute**" or in its "**position on any issue of law raised by the appeal**." 802 KAR 1:010(6)(a) and (b). (Emphasis added.) And despite its feeble attempt, the Petitioner cannot now logically argue that a question it asked during one of a multitude of depositions (the Petitioner's "*discovery*") somehow preserved the ERISA issue for review. With absolutely no mention of the ERISA issue in any pleading prior to the post hearing brief, whatsoever, it simply cannot logically be argued (as the Petitioner attempts to do) that the

issues in this case were so closely related that the phrasing of the protest and appeal to Revenue and KBTA sufficiently included the federal pre-emption issue. *Babcock and Wilcox Company v. Revenue Cabinet,* 203 S.W.3d 149 (Ky. 2006). For example, the Petitioner argued a multitude of reasons why its property was not subject to tax: the doctrine of contemporaneous construction; the property had no value; the tax was not a property tax but an "in lieu of" tax; accord and satisfaction, etc. Not once is there mention of ERISA.

B. ERISA DOES NOT PRE-EMPT KRS 136.320.

The *Urella* Court also held, just as the KBTA did here, that even if the issue before it was preserved for review, the result would not have been different: "Nor would the result be different had the issue been properly preserved." *Urella*, 939 S.W.2d at 873.

The KBTA in this case found that KRS 136.320 has not been shown to have any connection or reference to any benefit plan; that it does not burden any ERISA plan that may exist; that it does not infiltrate the relationship between employees and their employers or their plan and is a neutral tax of general application. (KBTA Order, pp. 9, 10.) The Petitioner argues that the KBTA's reliance on *Miller v. PPG Indus., Inc.*, 237 F. Supp. 2d 756 (W.D. Ky. 2002) is inapplicable and misplaced because the "ad valorem tax at issue in this case has much more than a remote or peripheral connection; it is, as discussed

supra, intimately connected." (*See* petition for writ, p. 30.) The Petitioner then fails to explain exactly how it is "intimately connected," and cites no authority for its position.

The Petitioner has also argued that there is a "growing split across the nation" with circuit courts of appeals and state courts concerning the ERISA issue. (*See* petition for writ, p. 31.) But it has not pointed to any genuine conflict with prior decisions of this Court or with any other circuit. Rather, it simply admonishes this Court for failing to "give proper weight to the clear text of ERISA" and for "mov[ing] away" from the intent of Congress in its rendition of the Opinion in *De Buono v. NYSA-ILA Medical and Clinical Services Fund,* 520 U.S. 806, 814-15, 117 S.Ct. 1747, 138 L.Ed.2d 21 (1997). (*See* petition for writ, pp. 25, 26.) Merely calling attention to this Court's decision in *De Buono* and expressing dissatisfaction with that decision does not satisfy this Court's requirement that a writ of certiorari will be granted only for compelling reasons.

Of course, *De Buono v. NYSA-ILA Med. & Clinical Serv. Fund*, 520 U.S. 806, is right on point in this matter. The issue in that case was whether a tax imposed upon gross receipts from patients using diagnostic services was a tax of general application having only an incidental impact on benefit plans, or a tax that "relates to" an ERISA fund by reducing the amount of fund assets, and therefore pre-empted. These fund assets, if not paid in taxes, would otherwise be available to provide plan members with

benefits, and a reduction in assets could cause the plan to limit its benefits or to charge plan members higher fees. The Second Circuit Court of Appeals held that ERISA pre-empted the tax statute because the tax reduced the fund's assets. But this Court remanded the case to the Second Circuit to reconsider the matter in light of its recently issued decision in *New York State Conference of Blue Cross & Blue Shield Plans v. Travelers Ins. Co.*, 514 U.S. 645, 115 S.Ct. 1671, 131 L.Ed.2d 695 (1995), in which no pre-emption was found.

However, the Second Circuit reinstated its judgment, distinguishing *Travelers* on the ground that the statute at issue there had only an indirect economic influence on the assets and the decisions of ERISA plan administrators, whereas the tax it was considering depleted the fund's assets directly, and thus had an immediate impact on an ERISA plan's assets and operations. The United States Supreme Court overturned the Second Circuit decision and held that Section 514(a) does not preclude New York from imposing a gross receipts tax on ERISA funded medical centers. It found that the Second Circuit relied substantially on an expansive and literal interpretation of the words "relate to" in § 514(a) of ERISA, and failed to give proper weight to *Travelers'* rejection of such a strictly literal reading.

In *Travelers*, the Court had unequivocally concluded that the "relates to" language was not intended to modify "the starting presumption that Congress does not intend to supplant state law." 514

U.S. at 654, 115 S.Ct. at 1676. This Court in *De Buono* held that the supposed difference between direct and indirect impact on the fund's assets – upon which the Second Circuit relied in distinguishing this case from *Travelers* – could not withstand scrutiny. The Supreme Court concluded that just because a tax may impact a fund's assets, that does not mean that pre-emption has occurred. Indeed, this decision undermines the Petitioner's entire argument that KRS 136.320 is "intimately connected" to the Separate Accounts and therefore pre-empted.

Importantly, the United States Supreme Court, the Sixth Circuit Court of Appeals and the U.S. District Court for the Western District of Kentucky, have *all* upheld a taxing authority's historical and fundamental right to tax without federal interference via ERISA. These opinions are consistent with the basic principles of federalism and comity between the federal and state governments, and between federal courts and state governments. In *Kentucky Ass'n of Health Plans, Inc. v. Miller*, 538 U.S. 329, 123 S.Ct. 1471, 155 L.Ed.2d 468 (2003), the Supreme Court was confronted with whether Kentucky had the right to impose a law on insurance companies requiring them to use any "willing provider," rather than a "closed network" of doctors, as an approved provider in their health plans. Following a decision by Sixth Circuit Court of Appeals affirming the District Court, the United States Supreme Court noted that ERISA explicitly preserves the validity of state "law[s] . . . which regulate insurance" under § 1144(b)(2)(A). *Id.*

at 1475. The Supreme Court also noted that the McCarran-Ferguson Act, 15 U.S.C. § 1012 requires that "No Act of Congress shall be construed to invalidate, impair or supersede ***any law enacted by any State for the purpose of regulating the business of insurance or which imposes a fee or tax upon such business*** . . . " *Id.* at 1476, fn. 2. (Emphasis supplied). *See also* 29 U.S.C. § 1144(b)(2)(A). In this case, KRS 136.320 was titled "Tax on taxable capital of domestic life insurance companies in lieu of other taxes." Clearly, this statute is intended to tax insurance companies. Moreover, Kentucky law is clear that "Amounts allocated by domestic life insurers to separate accounts in the exercise of the power granted by this section ***shall be owned*** by the insurer ***and the insurer shall not be, or hold itself to be, a trustee***, in respect to such amounts." KRS 304.15-390(6). (Emphasis supplied.)

The Western District of Kentucky reached a similar decision when concluding that a Louisville/ Jefferson County municipal occupational tax was not pre-empted by ERISA. *Miller*, 237 F. Supp. 2d at 756. In that matter, Miller sued his employer, PPG, in Jefferson Circuit Court, alleging that PPG failed to make proper contractual payments owed to Miller once he became disabled. PPG removed the case to federal court arguing that ERISA pre-empted all three of Miller's claims. *Id.* at 757-58. Miller then filed a motion to remand the case back to state court.

PPG argued that ERISA pre-empted the occupational license tax provisions, so as to give the

federal court jurisdiction over the matter. In terms of pre-emption, then, the question before the court was whether ERISA pre-empted the "insurance payments" exception to the municipal occupational license tax. However, the court held:

> *. . . the Supreme Court has also more recently sought to preserve the principle that "the preemption provision . . . is not without limits," Kentucky Assoc. of Health Plans, Inc. v. Nichols*, 227 F.3d 352, 358 (6th Cir. 2000), and has critiqued the emphasis on the ERISA text as an "uncritical literalism" that makes ERISA preemption turn on "infinite connections." *New York State Conference of Blue Cross & Blue Shield Plans v. Travelers Ins. Co.*, 514 U.S. 645, 656, 115 S.Ct. 1671, 131 L.Ed.2d 695 (1995). Thus, in *Travelers*, the Supreme Court held that ERISA's "relate to" language was not intended to modify "*the starting presumption that Congress does not intend to supplant state law.*" *Id.* at 705, 115 S.Ct. 1671. *The preemption analysis therefore begins by first analyzing "whether the normal presumption against preemption has been overcome in a particular case." Id.; see also De Buono v. NYSA-ILA Medical & Clinical Services Fund*, 520 U.S. 806, 814-15, 117 S.Ct. 1747, 138 L.Ed.2d 21 (1997).
>
> To determine if this presumption has been overcome, the Supreme Court's approach requires courts to "go beyond the unhelpful text and the frustrating difficulty of defining its key term, and *look instead to the*

> *objectives of the ERISA statute as a guide to the scope of the state law that Congress understood would survive." De Buono*, 520 U.S. at 813-14, 117 S.Ct. 1747; *see also Egelhoff v. Egelhoff*, 532 U.S. 141, 147, 121 S.Ct. 1322, 149 L.Ed.2d 264 (2001); *Associated Builders & Contractors v. Perry*, 115 F.3d 386, 392 (6th Cir. 1997) (noting that the "most recent Supreme Court approach" requires courts to look instead at the purpose of ERISA rather than the overly expansive "relate to" test).

Id. at 760-761. (Emphasis supplied.)

Miller specifically relied on two Sixth Circuit cases, both dealing with issues of state and local taxation in the ERISA context, which support Revenue's position herein. The *Miller* court discussed the cases of *Firestone Tire & Rubber Co. v. Neusser*, 810 F.2d 550 (6th Cir. 1987) ("tax has no connection or reference to the benefit plans. The tax commissioner has not directed any action at the plan contribution or payments," and the tax is a "neutral tax of general application." *Id.* at 554); and *Thiokol Corp. v. Roberts*, 76 F.3d 751 (6th Cir. 1996) (municipal occupational tax in no way infiltrates the relationship between employers or plans and their employees, but rather affects the relationship between the state and a taxpayer – an area where "ERISA has nothing to say" (Emphasis supplied.)

As a result, the court held that PPG failed to overcome the starting presumption that "Congress

did not intend to supplant state law," and declined to find ERISA pre-emption of the Louisville/Jefferson County insurance exemption. *Id.* at 762.

The rule of law set down by the United States Supreme Court, the United States Court of Appeals for the Sixth Circuit and the United States District Court for the Western District of Kentucky must be followed in this case. "[T]he preemption provision . . . is not without limits." *Miller* at 760; *quoting Kentucky Assoc. of Health Plans, Inc. v. Nichols*, 227 F.3d 352, 358 (6th Cir. 2000). The pre-emption analysis therefore begins by first analyzing "whether the normal presumption against pre-emption has been overcome in a particular case." *Id. See also De Buono*, 520 U.S. at 814-15.

A cursory review of the transcript of evidence in this case shows not only has the presumption against pre-emption not been overcome by the Petitioner, but also that ***no attempt to overcome the presumption was even made***. Aside from general testimony that Separate Accounts *might* be retirement accounts, absolutely no evidence was offered to show that Separate Accounts were ERISA qualified accounts, or more importantly, that ERISA somehow pre-empts KRS 136.320. Nowhere is there proof, testimony or otherwise, that KRS 136.320 has any connection or reference to the "retirement plans" that Separate Accounts are claimed to be. No proof was offered that indicates that KRS 136.320 takes any action directed at the plan contributions or payments. There was no

proof, obviously, because the Petitioner had just raised the ERISA issue on the day of the hearing.

KRS 136.320 is simply a *neutral property tax of general application,* and does not burden Separate Accounts or affect their operation. It does not infiltrate the relationship between employers or plans and their employees. Rather it affects the relationship between the state and the Petitioner – the taxpayer – an area where "ERISA has nothing to say." *Miller*, 237 F. Supp. 2d 756; *Firestone*, 810 F.2d 550; *Thiokol*, 76 F.3d 751. Clearly, the Court of Appeals properly concluded that the Petitioner's argument concerning ERISA's pre-emption of KRS 136.320 was not preserved for review, and the KBTA properly determined that even if the issue was preserved, it was baseless.

C. *ST. LEDGER* DID NOT INVOLVE THE CAPITAL STOCK TAX.

1. Background Concerning Calculation of Capital Stock Tax.

Capital Stock Tax liability is calculated pursuant to KRS 136.320. As illustrated by the chart below,[8] the "Total Taxable Value of Capital" ("TTVC"), is based on the fair cash value of certain intangible

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[8] Items #1-3 for each Chart come from Appellant's Annual Report of Domestic Life Insurance Companies as of the beginning of business Jan. 1, 1996 ("1996 Annual Report"). (Box 4, Vol. 28, Tab 49).

personal property, or capital ("Total Capital"), less *exempt* intangible personal property ("Exempt Property"). A statutory formula allocates TTVC between reserves ("Reserves") and nonreserves, also referred to as capital ("Capital/Nonreserves"). KRS 136.320(2). A company ascertains and reports its "Net Reserves" (Reserves less due and deferred premiums). KRS 136.320(1)(c). Next, a ratio is determined, which equals TTVC divided by Total Capital (the "Ratio"). KRS 136.320(2)(b). Net Reserves are multiplied by the Ratio to compute taxable Reserves. *Id.* Taxable Reserves are deducted from TTVC to calculate Taxable Capital/Nonreserves. KRS 136.320(2)(a). Again, taxable Reserves are taxed at a significantly lower rate:

Capital Stock Tax Return Calculations	All Assets (Stock & Non-Stock)	Non-Stock Assets	Stock
1. Net Reserves	2,782,888,351	2,569,123,985	213,764,366
2. Fair Cash Value of Capital	3,051,556,416	2,817,154,622	234,401,794
3. TTVC (#2 minus $148,054,938 in Exempt Intangible Property (other than Assets))	2,903,501,478	2,669,099,694	234,401,794

4. Ratio: TTVC to Fair Cash Value (#3 divided by #2)	0.9515	0.9474	1.0000
5. Taxable Reserves (#1 multiplied by #4)	2,647,868,608	2,434,104,242	213,764,366
6. Taxable Capital/ Nonreserves (#3 minus #5)	255,632,870	234,995,442	23,167,455
7. Tax on Reserves (#5 multiplied by Tax Rate of $.001/$100)	26,479	24,341	2,138
8. Tax on Capital/ Nonreserves (#6 multiplied by Tax Rate of $0.70/$100)	1,789,430	1,644,968	144,462
9. Total Tax (#8 + #9)	1,815,909	1,669,309	146,600
10. % of TTVC Allocated to Taxable Reserves	0.911957038	0.911957038	0.911957038

When Stock is taxed, 91% of all taxable assets, including Stock, are attributed to taxable Reserves.

Stock, as listed in the Petitioner's 1996 Annual Report, equaled $234,401,794. Therefore, the tax liability attributable to Stock is $146,600 ($2,318 in tax on Reserves plus $144,462 in tax on Capital/Nonreserves). If Stock is not taxed, the tax liability is $146,600 less, assuming non-Stock taxable assets ("Taxable Assets") remain the same. This is because similar property must be taxed similarly. Ky. Const. § 174.

The Ratio is critical, as it allocates a proportionate share of Exempt Property to Net Reserves. Without the Ratio, *all* Exempt Property is attributed to taxable Capital/Nonreserves, and taxable Reserves are artificially inflated. Notably, the Petitioner *itself exempts* Exempt Property on its returns.[9] Appellant has never objected to Exempt Property being exempted, although presumably the same taxation concerns would apply.

It is clear that, if it were not for the fact that two (2) tax rates are applied, one for Reserves and one for Capital/Nonreserves, there would be no dispute. That is, if the $0.70 per $100 value tax rate applied to all taxable assets, it would not matter whether Stock was "excluded" or "exempted"; the tax liability would be the same. However, the ultimate tax liability differs by more than $1.4 million, which is traced to the

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[9] The 1996 Annual Report lists $148,054,938 in non-Stock Exempt Property. (Box 4, Vol. 28, Tab 49)

application of the Ratio to Net Reserves to calculate taxable Reserves.

Net Reserves are part of TTVC, and a certain percentage of TTVC is allocated to taxable Reserves. Just as both the Statement Value of Capital and Fair Cash Value of Capital are less under MET (because Stock is excluded from those amounts), Net Reserves should also be less. However, as shown by the chart below, this does not occur:

Capital Stock Tax Return Calculations	Stock Taxed as Capital	MET	Difference
1. Fair Cash Value of Capital	3,051,556,416	2,817,154,622	234,401,794
2. TTVC (#1 minus $148,054,938 in Exempt Property (other than Stock))	2,903,501,478	2,669,099,694	234,401,794
3. Ratio: TTVC to Fair Cash Value (#2 divided by #1)	0.9515	0.9474	N/A
4. Taxable Reserves ($2,782,888,351 in Net Reserves multiplied by #3)	2,647,868,608	2,636,634,269	11,234,339

5. Taxable Capital/ Nonreserves (#2 minus #4)	255,632,870	32,465,415	223,167,455
6. Tax on Reserves (#4 multiplied by Tax Rate of $.001/$100)	26,479	26,366	113
7. Tax on Capital/ Nonreserves (#5 multiplied by Tax Rate of $0.70/$100)	1,789,430	227,258	1,562,172
8. Total Tax (#6 + #7)	1,815,909	253,624	1,563,285
9. % of TTVC Allocated to taxable Reserves	0.911957038	0.987836567	0.047927700
10. % of TTVC Allocated to taxable Capital/ Nonreserves	0.088042962	0.012163433	0.952072300

The second column of this table *includes* Stock in Capital, while the third column *excludes* Stock pursuant to MET. The final column shows the difference between the two methods, which should equal the tax liability attributable to Stock, or $146,600.

However, under MET, the tax liability decreased by $1,562,285, an amount ten times greater than expected! Disturbingly, by virtue of excluding Stock, the Petitioner pays *$1.4 million less* tax than another taxpayer who owns an *identical* amount of Taxable Assets, but has no Stock to exclude. While the Petitioner alleges that the Exemption Method is unconstitutional, MET unconstitutionally taxes identical assets differently. This $1.4 million difference results from the failure of MET to exclude any Stock from Net Reserves. As shown above, while more than *90%* of total Capital is allocated to Net Reserves, less than *5%* of Stock is allocated to Net Reserves under MET.

This also affects taxable Reserves, as the tax liability decreases by only $113 and not the full amount attributable to Stock: $2,138. Under the MET, a company pays $2,125 more in tax on taxable Reserves than a company who owns the same amount of Taxable Assets, but has no Stock to exclude. This is hidden by (i) the low tax rate on taxable Reserves, and (ii) the tremendous decrease in taxable Capital/ Nonreserves, which combine for a decrease in the overall tax liability. If there is any taxation of Stock, it is through the MET, which effectively increases taxation of taxable Reserves. *National Life Ins. Co. v. United States*, 277 U.S. 508, 579, 48 S.Ct. 591, 72 L.Ed. 968 (1928). This result is also at odds with Petitioner's insistence that Stock must be excluded from the formula.

However, if a proportionate share of Stock, 91% is excluded from Net Reserves (the "True Exclusion

Method"), as shown below, it is interesting to note the result:

Capital Stock Tax Return Calculations	Stock Taxed as Capital	True Exclusion Method	Difference
1. Net Reserves	2,782,888,351	2,569,123,985	213,764,366
2. Fair Cash Value of Capital	3,051,556,416	2,817,154,622	234,401,794
3. TTVC (#2 minus $148,054,938 in Exempt Intangible Property (other than Stock))	2,903,501,478	2,669,099,694	234,401,794
4. Ratio: TTVC to Fair Cash Value (#3 divided by #2)	0.9515	0.9474	N/A
5. Taxable Reserves (#1 multiplied by #4)	2,647,868,608	2,434,104,242	213,764,366
6. Taxable Capital/ Nonreserves (#3 minus #5)	255,632,870	234,995,442	23,167,455
7. Tax on Reserves (#5 multiplied by Tax Rate of $.001/$100)	26,479	24,341	2,138

8. Tax on Capital/ Nonreserves (#6 multiplied by Tax Rate of $0.70/$100)	1,789,430	1,644,968	144,462
9. Total Tax (#8 + #9)	1,815,909	1,669,309	146,600
10. % of TTVC Allocated to Taxable Reserves	0.911957038	0.911957038	0.911957038

When the True Exclusion Method is used, the inconsistencies resulting from MET disappear. The reduction in tax liability is the expected amount, $146,600, and the taxation of Reserves vanishes, as tax liability is again reduced by $2,138. All TTVC is allocated between taxable Reserves and Capital/ Nonreserves, so taxpayers owning the same amount of Taxable Assets have the same tax liability, *regardless* of whether they also own Stock. If the Petitioner wishes to exclude Stock from the calculation of Capital Stock Tax liability, a proportionate share of Stock must also be excluded from Net Reserves, because of the nature of the formula, and this it has failed to do.

In addition to the fundamental errors already identified, there are other problems related to MET that demonstrate its flawed nature. For example, as shown in the 1995 tax return, under MET, taxable Reserves *exceed* TTVC. As a result, 105% of TTVC is

taxed as taxable Reserves, while taxable Capital/Nonreserves is approximately *negative* $140 million. Neither figure makes any sense. Taxing taxable Reserves at 105% of TTVC essentially taxes these assets above fair cash value, violating the Kentucky Constitution. *Fitzpatrick v. Patrick*, 410 S.W.2d 143, 145-146 (Ky. 1966). The creation of a negative amount of taxable Capital/Nonreserves is the *only* way Petitioner can avoid paying tax on more than 100% of its TTVC.

Judge Thompson, in his dissent, which Petitioner cites on page 13 of its petition, addresses none of this, holding only that because the Exemption Method results in a higher tax assessment, it must tax Stock. As the majority correctly noted:

> Monumental's method, however, results in what we believe to be a manifestly illogical result. For example, under the method proposed by Monumental, its 1995 tax return would report total capital equal to negative $145 million. Such a result cannot be reconciled with the sort of logic one normally expects to find in tax statutes.
>
> Moreover, if the situation is considered whereby two hypothetical domestic life insurance companies with the same dollar amount of "taxable capital," one with substantial stock holdings and the other with little or no stock in its investment portfolio, the former would pay much less tax. Such disparate treatment would violate Section 171 of the Kentucky Constitution, which

> requires uniform taxation of all property within the same class. This difficulty is avoided entirely if the stock is exempted rather than excluded in calculating the tax.

Monumental Life, 294 S.W.3d at 20.

2. The Petition Fails to Demonstrate Any Conflict Between The Kentucky Court of Appeals' Holding on Stock and This Court's Precedents in *St. Ledger* and *Fulton*.

Petitioner makes a bold and unsupported assertion that the Court of Appeals' holding in this case is in direct conflict with this Court's holdings in *St. Ledger* and in *Fulton Corp. v. Faulkner*, 516 U.S. 325, 116 S.Ct. 848, 133 L.Ed.2d 796 (1996). However, the sole basis for Petitioner concluding that such a direct conflict exists is that Petitioner believes it should be entitled to an even greater refund than it received even though the facts, the statute and the law all fail to support Petitioner on this point.

In *St. Ledger*, this Court held only that the case should be remanded to the Kentucky Supreme Court in light of *Fulton*. What this Court held in *Fulton* was that "a State found to have imposed an impermissibly discriminatory tax retains flexibility in responding to this determination." *Fulton*, 516 U.S. at 346, quoting *McKesson Corp. v. Division of Alcoholic Beverages and Tobacco, Fla. Dept. of Business Regulation*, 496

U.S. 18, 39-40, 110 S.Ct. 2238, 110 L.Ed.2d 17 (1990). Moreover:

> . . . a State might refund the additional taxes imposed upon the victims of its discrimination or, to the extent consistent with other constitutional provisions (notably due process), retroactively impose equal burdens on the tax's former beneficiaries. A State may also combine these two approaches. Ibid. These options are available because the Constitution requires only that "the resultant tax actually assessed during the contested tax period reflec[t] a scheme that does not discriminate against interstate commerce." Id. at 41.

Fulton, 516 U.S. at 346-47. This Court finally concluded:

> Where "the federal constitutional issues involved [in the remedial determination] may well be intertwined with, or their consideration obviated by, issues of state law," our practice is to leave the remedy for the state supreme court to fashion on remand.

Id. at 347, *quoting Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 277 104 S.Ct. 3049, 3058, 82 L.Ed.2d 200 (1984), and *Tyler Pipe Industries v. Dept. of Revenue*, 483 U.S. at 252, 107 S.Ct. at 2822. *See also Williams v. Vermont*, 472 U.S. 14, 28, 105 S.Ct. 2465, 2474, 86 L.Ed.2d 11 (1985).

Notably, the Petitioner received a $1,470,357.49 refund as a result of the Department exempting stock.

As a result, Petitioner received a refund of the additional ad valorem taxes imposed on its shares of stock, which is consistent with this Court's directives in both *St. Ledger* and in *Fulton*.

However, Petitioner insisted it was entitled to an additional refund in the amount of $6,751,758 in refunds, based on its erroneous belief that Stock must be treated a different way. The Commerce Clause was not intended to grant interstate commerce a tax windfall. *Western Live Stock v. Bureau of Revenue*, 303 U.S. 250, 254, 58 S.Ct. 546, 82 L.Ed. 823 (1938). Simply because Petitioner could be entitled to a larger refund under some other method does not mean that Stock is being taxed, and the facts of this case shows that this is indeed the case – Stock is not taxed under the Exemption Theory.

Notably, whether the Exemption Method is used, the True Exclusion Method is used, or the tax liability attributable to Stock is subtracted from the total tax liability, the result is the same. This makes sense as exempting Stock from tax and excluding Stock from tax *should* have the same result. As the chart clearly shows, Stock is not taxed, as the difference in total tax liability under the Exemption Method is due *solely* to Stock's exempt status, no more, no less.

This result is consistent with the examples presented to Petitioner's own expert, Richard Pomp. (TE, pp. 130-132) In the first example, A and B each owned $100 of stock (A and B's other assets and tax liability were assumed to be the same). A's stock was

taxed at 6%, so A paid an additional $6 in tax, while B's stock was treated as exempt, and B paid no additional tax. When asked if B was taxed on the stock in this example, Richard Pomp testified that "if there is no tax at all, I would say he is not being directly taxed." (TE, pp. 131-132) The second example taxed half of A's stock at 2% and half of A's stock at 6%, while B's stock was again exempted. *Id.* Again, if A paid $4 in tax on $100 in stock, and B paid no tax on $100 of stock, Pomp testified that B would *not* be taxed on the stock (TE, p. 132) Again, no tax is paid on Stock under the Exemption Method, therefore, *even the Petitioner's expert* agreed Stock is not taxed.

Obviously, if Stock is not being taxed in the first place, double taxation of Stock is an impossibility. The Court of Appeals' interpretation of the Bank Shares Tax is completely consistent with the holding in *St. Ledger*. This interpretation gets to the same place as *St. Ledger*, where Stock is not taxed, either directly or indirectly, while under the Petitioner's theory, the taxation of taxable Reserves is increased. It is only because of the much lower rate associated with taxable Reserves that the total tax liability appears to be less.

As clearly and consistently shown, the amount the Petitioner was refunded was equal to the amount of Bank Shares Tax attributable to the Stock, no more, no less. Nothing in this Court's opinions mandates a different result, and there is no conflict between these opinions and the Court of Appeals' decision.

a. The Court of Appeals' Decision to Treat Stock as Exempt Intangible Assets is Consistent with this Court's Opinions.

Tellingly, Petitioner has pointed to no conflict with prior decisions of this Court. To be sure, Petitioner has strung together various snippets, including dissenting opinions, in an effort to support such a claim. Pet. pp. 37-39. But one searches the petition in vain for a summary of the facts, an explanation of the holding, or any attempt to put the decisions in context, and Petitioner makes no serious effort to show that they conflict with the ruling below.

For example, Petitioner insists it was entitled to an additional refund in the amount of $6,751,758, based on its erroneous belief that Stock must be treated a different way. The test advocated by Petitioner "still less tax under another theory," is not the correct test. The test used by this Court in *National Life* was whether the taxpayer derived any tax benefit from federally exempt securities. *National Life*, 277 U.S. at 519. This Court compared the tax liability for a company with tax-exempt securities against what the tax liability would be if the securities were not exempt, and concluded the tax liability was the *same* in both scenarios. As a result, the tax exemption was effectively, and impermissibly, disregarded. *Id.* However, as shown above, the Exemption Method satisfies the *National Life* test, and there is no conflict.

For example, Petitioner mischaracterizes the holding in *American Bank & Trust Co. v. Dallas Co.*, 463 U.S. 855, 103 S.Ct. 3369, 77 L.Ed.2d 1072 (1983). Petitioner states that this Court held the tax [on federal obligations] is barred regardless of its form if federal obligations must be considered, either directly or indirectly, in computing the tax." *Id.* at 862. Specifically, Rev. Stat. § 3701 exempted certain federal obligations from taxation by the states, and expressly provided that "[t]his exemption extends to every form of taxation that would require that either the obligations or the interest thereon, or both, be considered, directly or indirectly, in the computation of the tax. . . ." *Id.* at 859. Texas had a bank shares tax, which determined the taxable value of the bank shares by including the value of these federal obligations. As a result, a portion of the tax was attributable to the exempted federal obligations. The plaintiff in this case argued that § 3701 mandated that the taxable value of the bank shares be reduced by the value of the federal obligations held by the bank. In this case, there is no statute similar to Rev. Stat. § 3701, and more importantly, under the Exemption Theory, none of the tax is attributable to Stock.

Petitioner also mischaracterizes the holding in *Hunt-Wesson, Inc. v. Franchise Tax Bd. of California*, 528 U.S. 458, 463-64, 120 S.Ct. 1022, 145 L.Ed.2d 974 (2000). In *Hunt-Wesson*, California eliminated a deduction, thereby increasing the tax owed, to the extent the taxpayer had nonunitary income. California was not entitled to directly tax nonunitary income, and this Court held that California could not

indirectly tax such income, through the disallowance of a deduction, either. This Court did note, however, that if California could show a reasonable effort to allocate the deduction between taxable and tax-exempt income, such a disallowance could be upheld, "even though such denials mean that the taxpayer owes more than he would without the denial." *Id.* at 466. However, California was unable to meet that burden. Once again, the problem was that the amount of tax owed included tax attributable to income that should otherwise be exempt. The amount of Capital Stock Tax owed by Petitioner, unlike Hunt-Wesson does not include tax on any of the Stock that Petitioner owes. As the numbers clearly show, the only items reflected in the amount of Capital Stock Tax owed are taxable property.

The Exemption Method clearly reduces the tax liability by the *exact* amount of tax attributable to Stock if it were subject to the Capital Stock Tax and taxpayers owning the same Taxable Assets have the same tax liability, *regardless* of whether or not they also own Stock. As a result, the exemption was given full force and effect, and there is no inconsistency with this Court's holdings in *Hunt-Wesson* and *American Bank*.

CONCLUSION

The cases the Petitioner cites in support of its position involve wholly dissimilar facts and legislation, and do nothing to challenge the holding of the

decision below. In addition, the challenged state statutory provisions were subsequently amended by the Kentucky General Assembly, making a decision on the merits of little help in resolving other cases.

The petition is full of factual distortions and misrepresentations of the statutes and law, including the omission of the preservation of the ERISA issue from the questions presented. Petitioner raises no serious doctrinal disagreement with the Kentucky Court of Appeals, but merely disputes whether that court properly applied settled precedents to the particular statutes under review.

As this Court has said "[w]e decline to reach the merits of this claim, however, because the courts below ruled that the claim was procedurally barred." *Jimmy Swaggart Ministries v. Board of Equalization of California*, 493 U.S. at 398. The petition for a writ of certiorari should be denied.

Respectfully submitted,

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(3)

No. 09-865

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IN THE

Supreme Court of the United States

MONUMENTAL LIFE INSURANCE COMPANY
(Successor in interest to COMMONWEALTH LIFE INSURANCE COMPANY),

Petitioner,

v.

DEPARTMENT OF REVENUE, FINANCE AND ADMINISTRATION CABINET, COMMONWEALTH OF KENTUCKY (f/k/a Revenue Cabinet); LOUISVILLE/JEFFERSON COUNTY METRO GOVERNMENT (f/k/a Jefferson County, Kentucky and the City of Louisville, Kentucky); and KENTUCKY BOARD OF TAX APPEALS,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE KENTUCKY COURT OF APPEALS

REPLY BRIEF

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RULE 29.6 CORPORATE DISCLOSURE STATEMENT

Petitioner's corporate disclosure statement was set forth at page *ii* of its Petition for a Writ of Certiorari, and there are no amendments to that statement.

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Towers Watson, 2010 Global Pension Asset Study (Jan. 2010), *available at* http://www.towerswatson.com/assets/pdf/966/GPAS2010.pdf. 1

REPLY BRIEF FOR THE PETITIONER

This Petition presents two questions: [1] whether ERISA[1] preempts the imposition of Ky. Rev. Stat. ("KRS") 136.320 *ad valorem* tax on retirement/pension plan assets held in Separate Accounts; and, [2] whether Kentucky must follow and apply this Court's Order in *St. Ledger*[2] as well as precedent in other cases. Respectfully, for the reasons set forth this Court should grant review on each question.

A. ERISA Tax Preemption and the Effect of This Court's Decisions are Recurring Issues of Great Importance To Countless Retirement/Pension Plans, Their Fiduciaries, Retirees and Sponsoring Businesses

Ad valorem property taxes are a mainstay of state revenue. Transitioning from an agrarian/manufacturing based economy to one based more on service/intangible property [*e.g.*, $13.2 trillion in U.S. pension assets in 2009],[3] states looking for revenue have turned their "taxing" attention to these tax bases.

KRS 136.320 remains the law today, and as taxpayers must comply with it, it is axiomatic that it is worthy of

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[1] 29 U.S.C. § 1144 ("ERISA").

[2] *St. Ledger v. Kentucky Revenue Cabinet*, 517 U.S. 1206 (1996) [See Pet. n. 3 for citation with full case history].

[3] *See* Towers Watson, 2010 Global Pension Asset Study (Jan. 2010), *available at* http://www.towerswatson.com/assets/pdf/966/GPAS2010.pdf.

this Court's focus. Under the Kentucky Court of Appeals' holding, the tax would continue to apply to ERISA-governed retirement/pension plan assets held in Separate Accounts. Other states have similar tax statutes. *See, e.g.*, Tenn. Code Ann. § 67-5-1205; Tex. Code Ann. § 11.02. Call it what they will, Kentucky is taxing pension assets – this violates ERISA.

The ERISA preemption question has been preserved for review by Petitioner ("Monumental"), though Respondents ("Kentucky") attempt to cast doubt. Kentucky's allusions to the contrary notwithstanding, the evidentiary record is indisputably clear that the Separate Accounts consist of retirement/pension plan assets and therefore, a compelling case for review is presented: whether ERISA preempts this state tax law applied to ERISA-governed plan assets because the tax has *an impermissible connection with* an employee benefit plan.

Moreover, the Brief in Opposition demonstrates Kentucky's repeated improper elevation of state law *over* federal law and this Court's decisions, including *St. Ledger*. *St. Ledger* did impact KRS 136.320 as confirmed by Kentucky itself in its Final Ruling. This Court's other precedent likewise applies. While this obviously does not concern Kentucky,[4] it should concern this Court.

Monumental respectfully disagrees with many of Kentucky's statements. For instance, though Kentucky

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[4] *See, e.g., Miller v. Johnson Controls, Inc.*, 296 S.W.3d 392 (Ky. 2009), *Petition for Certiorari filed*, No. 09-981 (U.S. Feb. 22, 2010).

claims it was not aware of the existence of Separate Accounts prior to 1998 [Opp. 4-6], the evidence established that Kentucky was aware – for decades. Separate Accounts were identified in each of the annual Blue Books that Kentucky concedes Monumental provided to it. *See* Reply App. 11a (where 1996 "Separate Accounts" line 24, page 2 is *the largest single line item*, $1,596,179,388 of $4,750,301,268 (or 33.6%) of the total assets reported). Countless other examples exist.

B. The ERISA Preemption Question Was Preserved and Warrants This Court's Time to Review and Resolve Conflicting Jurisprudence

"The issue [of] whether a federal question was sufficiently and properly raised in the state courts is itself ultimately a federal question, as to which this Court is not bound by the decision of the state courts." *Street v. New York*, 394 U.S. 576, 583-85 (1969). Kentucky has it backwards in its Brief. Opp. 7.

1. Kentucky Cannot Bar This Court from Reviewing the ERISA Preemption Question Via an Erroneously Invoked and Unevenly Applied Procedural Rule

"State courts may not avoid deciding federal issues by invoking procedural rules that they do not apply evenhandedly to all similar claims." *Hathorn v. Lovorn*, 457 U.S. 255, 262-65 (1982). Monumental preserved the ERISA preemption question for this Court's review

under this Court's rules for preserving a challenge to a state law repugnant to federal law:

> It is well settled that in challenging the validity of a state law on the ground that it is repugnant to the Constitution of the United States, "[n]o particular form of words or phrases is essential, but only that the claim of invalidity on the ground therefor be brought to the attention of the state court with fair precision and in due time. And if the record as a whole shows either expressly or by clear intendment that this was done, the claim is to be regarded as having been adequately presented."

PruneYard Shopping Center v. Robins, 447 U.S. 74, 85, n. 9 (1980) (citations omitted).

Analysis begins with the Court of Appeals stating, "Monumental does not cite us to its preservation of this issue as required by CR 76.12(4)(c)," then considering quotes by the Kentucky Board of Tax Appeals ("KBTA") which stated that it would "not consider the ERISA issue" (though the KBTA ultimately ruled on the ERISA preemption question on the merits) [Pet. App. 64a], further stating, "As we have otherwise not been cited to Monumental's proper preservation of the issue, we will likewise not address this argument on the merits." Pet. App. 24a (citations omitted).

Kentucky Rule of Civil Procedure ("CR") 76.12(4)(c) requires "a statement with reference to the record showing whether the issue was properly preserved for

review and, if so, in what manner." Kentucky's Civil Rules, including CR 76.12(4)(c), are *not strictly construed*, and dismissal (the effect of not hearing a question on the merits) is disfavored. *See Ready v. Jamison*, 705 S.W.2d 479, 481-82 (Ky. 1986); *Cornette v. Holiday*, 32 S.W.3d 106, 109 (Ky. App. 2000); *Johnson v. Smith*, 885 S.W.2d 944, 950 (Ky. 1994).

The Court of Appeals routinely decides issues on the merits without a CR 76.12(4)(c) statement, for example, when (as here) the issue was clearly joined at every stage [*Cornette*, 32 S.W.3d at 109; *Baker v. Campbell County Bd. of Educ.*, 180 S.W.3d 479-82 (Ky. App. 2005)] or to "avert a manifest injustice" [*Southside Real Estate Developers, Inc. v. Pike County Fiscal Court*, 294 S.W.3d 453, 457 (Ky. App. 2009) (quotation omitted)]. And, demonstrating *per se* inconsistent application herein – in *Southside* the Court *addressed a federal preemption question* in the absence of a CR 76.12(4)(c) statement. *Id.*

The Court of Appeals has *routinely ignored* the CR 76.12(4)(c) statement – *but inexplicably not here* – even though Monumental raised a federal ERISA preemption question *and* briefed and defended it at every stage, *i.e.*, KBTA, Circuit Court and Court of Appeals. Thus, unlike the ruling State Courts in *Jimmy Swaggart Ministries v. Board of Equalization*, 493 U.S. 378, 397-99 (1990) and *Cousins v. Wigoda*, 419 U.S. 477, 486-87 (1975) [Opp. 12-13], the Court of Appeals' refusal to address ERISA preemption under a procedural rule was in error, unevenly applied and inherently prejudicial to Monumental.

2. Monumental Timely and Properly Presented the ERISA Preemption Question to the KBTA

Monumental presented the ERISA preemption question under KBTA rules and practice by appealing the taxation of Separate Accounts *issue* and making the ERISA preemption *argument* to the KBTA.

KRS 131.340(1) governs a *de novo* appeal from a Final Ruling: "The [KBTA] is . . . vested with exclusive jurisdiction to hear and determine appeals from final rulings . . . of any agency of state...government affecting . . . taxation. [KBTA] [a]dministrative hearings...shall be de novo. . . ." In a KBTA appeal, an "issue" has a particular meaning. *Stoner Creek Stud, Inc. v. Revenue Cabinet*, 746 S.W.2d 73, 77 (Ky. App. 1987), for example, upheld the KBTA's refusal to address the "issues" of the taxability of motor fuels and catalog purchases though the KBTA addressed others. *Id.* at 74-77. Obviously, an "issue" is an item, the taxability of which is questioned in a Final Ruling, *e.g.*, motor fuels, catalog purchases, etc.

An "issue" can encompass multiple "arguments." For example, post-*Stoner Creek*, in *Ellis Race & Entm't Ctr., Inc. v. Revenue Cabinet*, 1995 WL 107364 (KBTA 1995), regarding the *issue* of the taxability of certain sales, the KBTA considered several "argument[s]" including federal due process and equal protection challenges, "constitutional provisions that [Ellis] had not previously

cited in its . . . petition of appeal or . . . prehearing order." Thus, in *Ellis*, the KBTA rejected a "strict waiver theory."[5]

Here, Respondent Kentucky Department of Revenue issued a Final Ruling to Monumental ("Kentucky's Final Ruling"), designating "Separate Accounts" as an "*issue*" in dispute: "***At issue*** concerning the assessments . . . of the . . . tax imposed by KRS 136.320 is the propriety of assessing . . . separate accounts." Reply App. 6a (emphasis added).

Monumental appealed the Separate Accounts "issue" in its KBTA Petition of Appeal in the "Issues" section: ". . . [T]his action involves . . . another . . . issue: whether . . ."Separate Account Statement" assets and reserves are included within the computation of Capital Stock Tax levied pursuant to KRS 136.320." Monumental also set forth its position, *i.e.*, that they are not. This met the KBTA's requirements for a Petition of Appeal.[6]

When a taxpayer preserves an issue (*i.e.*, Separate Accounts' taxability) in its KBTA Petition of Appeal as Monumental did, that taxpayer may then advance

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[5] *See also Revenue Cabinet v. Babcock & Wilcox Co.*, 203 S.W.3d 149, 155 (Ky. App. 2005) (holding that the issue of an account's taxability was properly before the KBTA); *CSX Corp. v. Dep't of Revenue*, No. K08-R-37, Order (unnumbered) (KBTA 2009) [Reply App. 9a-10a].

[6] Notably, 802 KAR 1:010, as in effect when this case was before the KBTA, did not require a pre-hearing statement. Kentucky's Brief in Opposition at pages 9, 10 & 15 improperly cites from a later version of the KBTA's Regulation.

multiple arguments (*e.g.*, ERISA preemption) on brief in support thereof. Thus, in contrast to the Petitioner in *Campbell v. Louisiana*, 523 U.S. 392, 403 (1998), cited by Kentucky. Monumental has met its burden of showing that the federal question (here, ERISA preemption) was adequately presented to the KBTA and to the Kentucky Court of Appeals so that this Court may review it. *See Street, supra; Hathorn, supra; Prune Yard, supra.*

3. ERISA Protects the Involved Plans, and Kentucky's Arguments Only Reinforce the Actual Conflict Between This Court's Opinions in *De Buono* vs. *Egelhoff* and Others, Particularly as to ERISA's "Connection With" Test

The Court of Appeals held that, "The separate account assets consist principally of retirement fund amounts held for distribution to retirees in the future." Pet. App. 20a. It is unfortunate that Kentucky now suggests that the record does not support the nature of the Separate Accounts, though Kentucky failed to assert this before the Kentucky Supreme Court. Merely one of many possible cites is demonstrative: Professor Richard D. Pomp testifying as an expert stated, "I think they [referring to the Separate Accounts] are covered by the pre-emption language in ERISA."[7]

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[7] The record overwhelmingly supports the Petitioner; multiple witnesses offered unrefuted testimony as to the nature of the Separate Accounts assets, including employees of Kentucky.

ERISA's express text evidences Congress' intent to preempt state tax laws that relate to employee benefit plans such as the Separate Accounts. *See* 29 U.S.C. § 1144(a)&(b)(5)(B)(i). Though citing it and other cases, Kentucky emphasizes *De Buono v. NYSA-ILA Medical & Clinical Services Fund*, 520 U.S. 806, 809 (1997), which held that ERISA did not preempt New York's gross receipts tax on the income of medical centers operated by ERISA funds. Opp. 17-18. *De Buono* gave little weight to Congress' preemptive intent in ERISA's text [*De Buono*, 520 U.S. at 815 n. 11], and Kentucky reads *De Buono* to create a virtually *per se* unrebuttable presumption against preemption of a general tax – this is not the law.

One conflict presented is that *De Buono* predates this Court's decision in *Egelhoff v. Egelhoff ex rel. Breiner*, 532 U.S. 141 (2001), which confirmed that ERISA preempts general laws having an "impermissible connection with" an employee benefit plan and made clear, "[T]hat presumption can be overcome where, as here, Congress has made clear its desire for preemption." *Id.* at 143, 147-52 (and legislative history discussed therein). Moreover, Kentucky has not disputed the multiple and significant connections (including state tax lien, personal liability, and licensure provisions) between the *ad valorem* tax at issue and the involved Separate Account retirement assets. *Compare*, Pet. 27-29, *with* Opp. 16-24.

In the nearly 36 years since ERISA's enactment, it is believed that this Court has opined only twice on ERISA preemption in the context of state and local taxes. The last time was in *De Buono* in 1997; the case

law has since evolved. Imposing *ad valorem* state and local tax on Separate Accounts consisting of ERISA-governed retirement/pension plan assets presents an ideal and needed vehicle for this Court to clarify its jurisprudence as to the preemptive effect of ERISA's text to general state and local taxes.

C. Kentucky Admits *St. Ledger* Applies to the KRS 136.320 Tax On Stock, and This Court's Precedents In *St. Ledger*, *Fulton* and Other Opinions Must Be Given Effect

"Law is not an exercise in mathematical logic." *Parents Involved in Community Schools v. Seattle School Dist. No. 1*, 551 U.S. 701, 831 (2007) (J. Breyer dissenting). Kentucky's ten pages of mind numbing permutations of tautological computations simply do not add up.[8] The "math" here does not control here any more than it did in *Fulton Corp.*, cited by this Court in *St. Ledger* in remanding this case back to the Kentucky Supreme Court [*St. Ledger*, 517 U.S. at 1206]. The converse is true – the law controls the math. Thus, the proper approach here is not to allow some contrived and unproven mathematical theorem to control the result, but rather for this Court's Order in *St. Ledger* to dictate how to compute the tax of KRS 136.320 [Pet. App. 82a-84a].

Kentucky's mathematical theory is flawed as Judge Thompson recognized in his dissent. Pet. App. 32a-33a.

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[8] And tellingly, Judge Thompson suggested at one of the two Court of Appeals' oral arguments herein that even he, a math major in college, did not follow Kentucky's theory.

Tax on stock valued at $234,401,794 is $1,640,813 (using the $0.70 per $100 rate for taxable capital [KRS 136.320(3)]), which is much closer to the tax resulting from "excluding" stock [$1,562,285], versus treating stock as "exempt" [$144,462] in the computation. *Compare with* Opp. 27 & 30. Again, law controls the math.

1. From the Outset of this Litigation, Kentucky Has Recognized that *St. Ledger* Had a Controlling Effect on the KRS 136.320 Tax

St. Ledger applied to the KRS 136.320 tax on stock, contrary to Kentucky's representations in its Brief in Opposition. Suggestions to the contrary are simply inaccurate. In 2000, Kentucky ruled [Reply App. 1a-4a]:

> At issue . . . is the application of the Commerce Clause principle of nondiscrimination against interstate commerce recognized and applied in *St. Ledger v. Revenue Cabinet.*
>
> * * *
>
> The . . . language [of KRS 136.320(2)(a)] is virtually indistinguishable from the language in KRS 132.020(1) levying the general intangible property tax, which was implicated in *St. Ledger.* . . .
>
> Included in the "company's intangible personal property exempt from taxation by law" or "exempt intangible personal

> property" is stock exempted under KRS 136.030, another statute whose constitutionality was at issue in *St. Ledger*. See KRS 136.320(1)(b) and (2)(a). . . .
>
> * * *
>
> Thus, KRS 136.320's utilization of KRS 136.030 in its computation of "taxable capital" rendered it violative of the United States Constitution's Commerce Clause in the same manner as KRS 132.020(1) and 136.030 were held in *St. Ledger* to contravene that constitutional provision.

(citations omitted).

St. Ledger had an effect on KRS 136.320; Kentucky admits this. On remand from this Court, the approach Kentucky selected to remedy the *St. Ledger* constitutional infirmity was to strike down both the exemption statute KRS 136.030[9] and the tax on stock in KRS 132.020(1).

Here, the Court of Appeals did not apply the remedy Kentucky selected for this particular constitutional infirmity, *i.e.*, striking "shares of stock" from the tax (KRS 136.320) statute [Monumental's position]; instead, its Opinion leaves the tax on stock intact and treats stock as exempt intangible personal property [Kentucky's

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[9] KRS 136.030 was in effect at all times during the underlying tax years involved herein, but was repealed effective January 1, 2006.

position]. Pet. App. 16a-17a. Kentucky's position is in clear conflict with *St. Ledger* and *Fulton*.

2. Kentucky Has Recognized that Stock Is Considered in the Tax Computation When Treated as Exempt Which Implicates This Court's Precedent

Kentucky erroneously suggests that *St. Ledger* is not controlling herein and should not be followed; to the contrary, Kentucky ruled that treating stock as exempt intangible personal property *requires* stock to be "considered" in the KRS 136.320 tax computation:

> [Kentucky] has based its calculation of the refunds due the taxpayer [Monumental] on an approach that ***retains stock in the computation*** of "capital" under KRS 136.320(1)(a) ***but later exempts all of it*** as "intangible personal property exempt from taxation by law" in arriving at "taxable capital." KRS 136.320(2)(a).

[Reply App. 4a] ([ ] and emphasis added).

KRS 136.320's tax computation, even when applying Kentucky's own words, "considers" shares of stock when it is treated as exempt intangible personal property and violates this Court's clear rules against taxing indirectly that which cannot be taxed directly; "consideration" of an item (*e.g.*, whether federal obligations, or here, stock) in a tax computation, directly or indirectly, effectively subjects it to tax as held by this Court. *See National Life Insurance Co. v. United States*, 227 U.S. 508 (1928);

American Bank & Trust Co. v. Dallas County, 463 U.S. 855 (1983); *Hunt-Wesson v. California*, 528 U.S. 458 (2000).

CONCLUSION

For the foregoing reasons and those stated in the Petition for a Writ of Certiorari, the Petition for a Writ of Certiorari should be granted and this action heard.[10]

Respectfully submitted,

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Counsel for Petitioner

[10] Alternatively, this Court should issue a "Grant, Vacate and Remand" Order.

APPENDIX

APPENDIX A — FINAL RULING LETTER OF THE KENTUCKY REVENUE CABINET DATED JULY 21, 2000

REVENUE CABINET
DEPARTMENT OF LAW
200 FAIR OAKS LANE
FRANKFORT, KENTUCKY 40620

July 21, 2000

Commonwealth Life Insurance Co./
Monumental Life Insurance Co.
C/O Aegon USA, Inc.
4333 Edgewood Road NE
Cedar Rapids, IA 52499

Gentlemen:

Commonwealth Life Insurance Company, also known as Monumental Life Insurance Company, hereinafter referred to as "Commonwealth" or taxpayer, has outstanding refund claims of state taxes paid pursuant to KRS 136.320 for the years 1990 through 1996 in the amount of $6,751,758.46 (plus applicable interest). In addition, Commonwealth has outstanding assessments of the state tax imposed by KRS 136.320 for the years 1995 through 1998 in the amount of $4,108,444.52 (plus applicable penalty and interest).

At issue with respect to the refund claims is the application of the Commerce Clause principle of nondiscrimination against interstate commerce recognized and applied in *St Ledger v. Revenue Cabinet*,

Ky., 912 S.W.2d 34 (1995), *cert. granted, judgment vacated and case remanded*, 517 U.S. 1206, 116 S.Ct. 1821, 134 L.Ed.2d 927, (1996), *on remand*, Ky., 942 S.W.2d 893 (1997), *cert. dism'd*, 521 U.S. 1146, 118 S.Ct. 27, 138 L.Ed.2d 1057 (1997).

Commonwealth is (or was) a life insurance company incorporated under the laws of and doing business in Kentucky as of January 1 of the years to which the refund claims at issue relate. KRS 136.320(1). It therefore was properly subject to the annual taxes on "taxable capital" that are imposed or authorized by KRS 136.320 for state, county and city purposes. KRS 136.320(1), (3), (4) and (5).

""Taxable capital' [is] determined by deducting 'taxable reserves' from 'capital,' less exempt intangible personal property." KRS 136.320(2)(a) "Capital" for purposes of this calculation is defined as follows:

> The fair cash value of the company's intangible personal property, hereinafter referred to as "capital," consisting of all money in hand, shares of stock, notes, bonds, accounts, and other credits, exclusive of due and deferred premiums, whether secured by mortgage, pledge, or otherwise, or unsecured.

The foregoing language is virtually indistinguishable from the language in KRS 132.020(1) levying the general intangible property tax, which was implicated in *St. Ledger*. *See St. Ledger v. Commonwealth*, Ky., 912 S.W.2d 34, 37, 39 (1995).

Appendix A

Included in the "company's intangible personal property exempt from taxation by law" or "exempt intangible personal property" is stock exempted under KRS 136.030, another statute whose constitutionality was at issue in *St. Ledger*. See KRS 136.320(1)(b) and (2)(a). Subsection 1 of KRS 136.030 states:

> The individual stockholders of a corporation shall not be required to list their shares for ad valorem taxation so long as the corporation pays taxes to the State of Kentucky on at least seventy-five percent (75%) of its total property, wherever located. Bonds and obligations of the United States of America and its possessions and bonds and obligations of the State of Kentucky, its instrumentalities, and its political subdivisions and their instrumentalities shall not be considered in the computation of the total property of the corporation, wherever located, nor in the computation of the amount of property upon which the corporation pays ad valorem taxes to the State of Kentucky. In order to obtain this exemption, the stockholder shall furnish satisfactory proof to the Revenue Cabinet that at least seventy-five percent (75%) of the total property of the corporation as hereinabove specified is taxed in the State of Kentucky.

Thus, KRS 136.320's utilization of KRS 136.030 in its computation of "taxable capital" rendered it violative of the United States Constitution's Commerce Clause

in the same manner as KRS 132.020(1) and 136.030 were held in *St. Ledger* to contravene that constitutional provision. That is, the provisions in question discriminated against interstate commerce by providing a direct commercial advantage to local business. This was accomplished by KRS 136.030's allowing an exemption to corporations "pay[ing] taxes to the State of Kentucky on at least seventy-five percent (75%) of its total property, wherever located" while denying an exemption to other corporations.

Commonwealth relies upon the *St. Ledger* decision to argue that its stock should be removed or excluded from the threshold computation of "capital" in KRS 136.320(1)(a). In other words, it would strike the word "stock" from KRS 136.320(1)(a) to exclude stock at the outset of the computation, thereby making it unnecessary to exempt it later on in the computation of "intangible personal property exempt from taxation by law." KRS 136.320(1)(b) and (2)(a). The Cabinet has based its calculation of the refunds due the taxpayer on an approach that retains stock in the computation of "capital" under KRS 136.320(1)(a), but later exempts all of it as "intangible personal property exempt from taxation by law" in arriving at "taxable capital." KRS 136.320(2)(a).

The Cabinet has already issued Commonwealth refunds for the years in question (1990 through 1996) in accordance with its approach as outlined in the immediately preceding paragraph. The amount of the outstanding refund claims stated in the very first

paragraph of this final ruling represents the additional amount Commonwealth contends is due it based upon its approach, which is also outlined above in the immediately preceding paragraph.

It is the Cabinet's position that its approach is the proper one in this situation. First, its approach comports with the Commerce Clause mandate, recognized and applied in *St. Ledger,* of equal treatment of, and nondiscrimination between, interstate and intrastate commerce. Commonwealth's approach goes far beyond what is necessary to redress any constitutional violation to grant itself a tax windfall. "It was not the purpose of the commerce clause to relieve those engaged in interstate commerce from their just share of state tax burden even though it increases the cost of doing business." *Western Life Stock v. Bureau of Revenue*, 303 U.S. 250, 254, 58 S.Ct. 546, 548, 82 L.Ed. 823 (1938).

Second, it is well settled that a cardinal principle of statutory construction is to save and not destroy. No more of a statute should be invalidated than is necessary to rectify a constitutional infirmity. in this situation, the only language that needs to be stricken to remedy the constitutional violation is the language in KRS 136.030(1) that follows "The individual stockholders of a corporation shall not be required to list their shares for ad valorem taxation."

It should also be noted that interest is not payable on any refund based upon the invalidity of KRS 136.320 that may be determined to be due in this proceeding.

See Revenue Cabinet v. St. Ledger, Ky. App., 955 S.W.2d 539, 544 (1997).

At issue concerning the assessments outstanding to Commonwealth of the state tax imposed by KRS 136.320 is the propriety of assessing what Commonwealth refers to as separate accounts. These accounts clearly include items that are capital within the meaning of KRS 136.320(1)(a) and should have been reported as such. Commonwealth's omission of these accounts from its report of capital pursuant to KRS 136.320 rendered it properly assessable by the Cabinet. There is ample authority for this action. *See, e.g.* KRS 136.320; 131.110; 131.130; 132.290; 132.320.

Based on the above, it is the position of the Cabinet that Commonwealth's outstanding refund claims have been properly denied and that the assessments outstanding (plus applicable penalty and interest) to the Commonwealth of Kentucky are properly due and owing.

This letter is the final ruling of the Revenue Cabinet.

You may appeal this ruling to the Kentucky Board of Tax Appeals pursuant to the provisions of KRS 131.110, KRS 131.340-131.365, 103 KAR 1:010 and 802 KAR 1:010. If you decide to appeal this ruling, you must file your complaint or petition of appeal with the Clerk, Kentucky Board of Tax Appeals, 128 Brighton Park Boulevard, Frankfort, Kentucky 40601, within thirty (30) days from the date of this letter. The rules of the Kentucky Board of Tax Appeals, which are set forth in

802 KAR 1:010, require that the complaint or petition of appeal must:

1. Be filed in quintuplicate;

2. Contain a brief statement of the law and laws in issue;

3. State the petitioner's position regarding the law, facts or both; and

4. Include a copy of this final ruling letter with each copy of the complaint or petition.

Proceedings before the Kentucky Board of Tax Appeals are conducted in accordance with 103 KAR 1:010, 802 KAR 1:010 and KRS 131.345-131.365. Formal hearings are held by the Board concerning the tax appeals before it, with all testimony and proceedings officially reported. Legal representation of parties to appeals before the Board is governed by the following rules set forth in Section 2(4) of 802 KAR 1:010:

1. An individual may represent himself in hearings before the Board;

2. An individual who is not an attorney may not represent corporations or individuals before the Board; and

Appendix A

3. An attorney who is not licensed to practice in Kentucky may practice before the Board if he obtains local counsel in compliance with Rule 3.030(2) of the Rules of the Kentucky Supreme Court.

You will be notified by the Clerk of the Board of the date and time set for any hearing.

Sincerely,
s/ George D. Renfro
GEORGE D. RENFRO
Assistant Director
Division of Protest Resolution

APPENDIX B — *CSX CORPORATION AND SUBSIDIARIES VS. DEPARTMENT OF REVENUE* NO. K08-R-37 (KBTA) – ORDER ON MOTION FOR AND MEMO IN SUPPORT OF LIMITING THE KENTUCKY DEPARTMENT OF REVENUE TO FINAL RULING DATED JUNE 3, 2009

COMMONWEALTH OF KENTUCKY
BOARD OF TAX APPEALS
FILE NO. K08-R-37

CSX CORPORATION AND SUBSIDIARIES

APPELLANT

vs.

FINANCE AND ADMINISTRATION CABINET
DEPARTMENT OF REVENUE

APPELLEE

****

This matter is before the Kentucky Board of Tax Appeals to limit the Department of Revenue to its final ruling. Hearings before the board are not limited to previous factual findings and recommendations of the Department or the taxpayer.

Therefore the motion is passed to the merits of the case and may be raised again at the appropriate time.

All other previous orders of the Board remain in effect.

DATE OF ORDER: June 3, 2009

KENTUCKY BOARD OF TAX APPEALS
FULL BOARD CONCURRING.

s/ William A. Hayes
William A. Hayes Chairman

APPENDIX C — ANNUAL STATEMENT ("BLUE BOOK") OF THE COMMONWEALTH LIFE INSURANCE COMPANY OF LOUISVILLE IN THE STATE OF KENTUCKY FOR THE YEAR ENDED DECEMBER 31, 2006 [SELECTED EXCERPTS – COVER PAGE AND PAGE 2 ONLY]

ANNUAL STATEMENT

OF THE

COMMONWEALTH LIFE INSURANCE COMPANY

OF

LOUISVILLE

IN THE STATE OF

KENTUCKY

TO THE

INSURANCE DEPARTMENT

OF THE

STATE OF

FOR THE YEAR ENDED
DECEMBER 31, 1996

1996

LIFE AND ACCIDENT AND HEALTH

1996

Appendix C

ANNUAL STATEMENT FOR THE YEAR 1996 OF THE COMMONWEALTH LIFE INSURANCE COMPANY

ASSETS

	Current Year				Prior Year
	1 Ledger Assets	2 Non-Ledger Assets	3 Assets Not Admitted	4 Net Admitted Assets (Cols. 1+2-3)	5 Net Admitted Assets
1. Bonds (Less $0 liability for asset transfers with o/s options, Schedule B, Part 3)	1,478,671,298	0	0	1,478,671,298	1,348,864,373
2. Stocks					
2.1 Preferred stocks (Schedule D, Part 2, Section 1)	87,288,845	0	0	87,288,845	95,388,722
2.2 Common stocks (Schedule D, Part 2, Section 2)	93,561,645	80,152,661	0	173,714,306	140,545,343
3. Mortgage loans on real estate (Schedule B, Part 1, Section 1)					
3.1 First liens	1,011,740,595	0	0	1,011,740,595	1,041,988,657
3.2 Other than first liens	0	0	0	0	0
4. Real estate (Schedule A, Part 1)					
4.1 Properties occupied by the company (Less $0 encumbrances)	38,699,163	0	0	38,699,163	38,899,110
4.2 Properties acquired in satisfaction of debt (Less ($1,500,000) encumbrances)	9,301,865	0	0	9,301,865	10,167,570
4.3 Investment real estate (Less $0 encumbrances)	135,354	0	0	135,354	632,667
5. Policy loans	172,156,353	0	0	172,156,353	150,893,367
6. Premium notes, including $0 for first year premiums	0	0	0	0	0
7. Collateral loans (Schedule C, Part 1)	0	0	0	0	0
8. Cash ($11,992,300, Schedule E-1) and Short-term investments ($42,617,469, Schedule DA Part 1)	54,609,769	0	0	54,609,769	53,613,960
9. Other invested assets (Schedule BA, Part 1)	169,339,583	0	1,429,933	167,909,650	167,109,893
10. Aggregate write-ins for invested assets	95,977	0	0	95,977	55,222
11. Subtotals, cash and invested assets (Lines 1 to 10)	3,118,955,650	80,152,661	1,429,933	3,196,678,378	3,020,139,858
12. Reinsurance ceded.					
12.1 Amounts recoverable from reinsurers (Schedule S, Part 3)	1,325,384	0	0	1,325,384	2,017,995
12.2 Commissions and expense allowances due	0	0	0	0	0
12.3 Experience rating and other refunds due	0	0	0	0	0
13. Electronic data processing equipment	0	0	0	0	0
14. Federal income tax recoverable	0	0	0	0	0
15. Life insurance premiums and annuity considerations due and uncollected on in force business (less premiums on reinsurance ceded and less $17,115,373 loadings)	0	27,627,881	0	27,627,881	23,237,352
16. Accident and health premiums due and unpaid	0	693,839	11,057	682,582	238,539
17. Investment income due and accrued (Exhibit 3)	0	50,828,124	0	50,828,124	50,997,168
18. Net adjustment in assets and liabilities due to foreign exchange rates	0	0	0	0	0
19. Receivable from parent, subsidiaries and affiliates	6,793,205	0	0	6,793,205	11,348,796
20. Amounts receivable relating to uninsured accident and health plans	0	0	0	0	0
21. Other assets nonadmitted (Exhibit 13)	893,995	0	893,995	0	
22. Aggregate write-ins for other than invested assets	25,113,645	1,461,752	6,066,268	20,508,829	21,313,305
23. Total assets excluding Separate Accounts business (Lines 11 to 22)	3,154,129,880	155,763,057	8,393,993	3,301,498,981	3,129,294,431
24. From Separate Accounts Statement	1,596,179,388			1,596,179,388	1,900,893,935
25. Totals (Lines 23 and 24)	4,750,301,268	155,763,057	8,393,993	4,897,698,791	4,156,388,126
DETAILS OF WRITE-INS					
0901. Financial futures and options	95,977			95,977	55,222
0902.					
0903.					
0996. Summary of remaining write-ins for Line 09 from overflow page	0	0	0	0	0
0999. Totals (Lines 0901 thru 0903 plus 0998) (Line 10 above)	95,977	0	0	95,977	55,222
2201. Miscellaneous admitted assets	966,468	1,339,362		2,305,830	9,111,573
2202. Separate accounts recoverable	6,098,231	142,230	180	7,602,130	9,190,482
2203. CSV Policy Trust	11,190,889			11,190,889	8,198,954
2298. Summary of remaining write-ins for Line 22 from overflow page	6,066,958	0	6,066,958	0	472,745
2299. Totals (Lines 2201 thru 2203 plus 2298) (Line 22 above)	25,113,646	1,461,752	6,066,256	20,508,829	21,313,305

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